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Supreme Court, U.S.
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No. 07-07-164

In The

Supreme Court of the United States

KINDER MORGAN CO_2 COMPANY, L.P.

Petitioner,

v.

RUSSELL GARY HEIMANN, PECOS SLOPE ROYALTY TRUST AND RIO PETRO LTD., INDIVIDUALLY AND ON BEHALF OF ALL OTHER PRIVATE ROYALTY AND OVERRIDING ROYALTY OWNERS IN THE BRAVO DOME CARBON DIOXIDE UNIT, NEW MEXICO, SIMILARLY SITUATED,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeals Of New Mexico

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the New Mexico Court of Appeals err in holding that the presumption favoring arbitration under the Federal Arbitration Act is less applicable to narrow arbitration clauses than broad arbitration clauses, consistent with decisions of the Second Circuit, Third Circuit, Sixth Circuit, Eighth Circuit, Tenth Circuit, and the Massachusetts Supreme Court, but contrary to decisions of the Fifth Circuit, the Eleventh Circuit, the D.C. Circuit, a district court in the Ninth Circuit, the Texas Supreme Court, and the Alaska Supreme Court?

2. Did the New Mexico Court of Appeals err in holding that arbitration under the Federal Arbitration Act may be denied based on lack of clarity in the plaintiffs' complaint, resolving doubts arising out of unclear allegations in favor of court litigation, contrary to the federal presumption in favor of arbitration and federal decisions requiring that doubts concerning arbitrability arising from vague pleadings be resolved in favor of arbitration?

3. Did the New Mexico Court of Appeals err in holding that arbitration under the Federal Arbitration Act may be denied based on a plaintiff's characterization of its claims and the legal labels a plaintiff places on its claims, contrary to decisions of the Fourth and Seventh Circuits?

4. Did the New Mexico Court of Appeals err in adopting a rule permitting broad construction of exclusionary clauses in arbitration agreements governed by the Federal Arbitration Act, contrary to a Fourth Circuit decision requiring that exclusionary clauses be construed narrowly in light of the federal presumption favoring arbitration?

PARTIES TO THE PROCEEDING

Petitioner Kinder Morgan CO_2 Company, LP is the defendant in the trial court proceedings, was the appellant in the proceedings in the New Mexico court of appeals, and was the petitioner in the proceedings in the New Mexico Supreme Court.

Respondents Russell Gary Heimann,[1] Pecos Slope Royalty Trust, and Rio Petro Ltd., individually and on behalf of other royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico, similarly situated, are plaintiffs in the trial court, were appellees in the proceedings in the New Mexico court of appeals, and were respondents in the proceedings in the New Mexico Supreme Court.

[1] At the inception of this case, J. Casper Heimann was a named plaintiff, but he died during the course of the proceedings in the trial court. J. Casper Heimann's son, Russell Gary Heimann, has been substituted as a plaintiff in lieu of J. Casper Heimann.

RULE 29.6 STATEMENT

Petitioner Kinder Morgan CO_2 Company, L.P. is a limited partnership that is wholly owned by Kinder Morgan Energy Partners, L.P., a master limited partnership that has partnership units that are traded on the New York Stock Exchange. The general partner of Kinder Morgan Energy Partners, L.P. is Kinder Morgan G.P., Inc., which owns all of the voting securities of Kinder Morgan Management, LLC. Pursuant to a delegation of control agreement, Kinder Morgan G.P. Inc. delegated to Kinder Morgan Management, LLC, to the fullest extent permitted under Delaware law and the applicable partnership agreement, all of its power and authority to manage and control the business and affairs of Kinder Morgan Energy Partners, L.P. Shares of Kinder Morgan Management, LLC are traded on the New York Stock Exchange.

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OPINIONS AND ORDERS BELOW

The opinion of the New Mexico court of appeals dated August 8, 2006, is reported at *Heimann v. Kinder Morgan CO_2 Company, L.P.*, 140 N.M. 552, 144 P.3d 111 (N.M. Ct. App. 2006), and is reproduced in the Appendix at App. 1-19. The order of the New Mexico Supreme Court dated October 11, 2006, granting Kinder Morgan CO2 Company, L.P.'s petition for writ of certiorari, is not reported and is reproduced in the Appendix at App. 22-23. The order of the New Mexico Supreme Court dated May 10, 2007, quashing the writ of certiorari, is not reported and is reproduced in the Appendix at App. 24-26. The order of the trial court denying Petitioner's motion for stay pending arbitration and to compel arbitration signed on March 8, 2005, and entered on March 11, 2005, is not reported and is reproduced in the Appendix at App. 20-21.

JURISDICTION

On August 8, 2006, the New Mexico court of appeals issued its decision affirming the trial court's denial of Petitioner's motion to compel arbitration and for stay pending arbitration. App. 1-19. Petitioner filed a timely petition for writ of certiorari with the New Mexico Supreme Court on August 28, 2006, which was granted by order dated October 11, 2006. App. 22-23. Following oral argument on May 7, 2007, the New Mexico Supreme Court entered an order on May 10, 2007, quashing the writ of certiorari as improvidently granted. App. 24-26.

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a), as the decisions of the New Mexico courts deprived Petitioner of its arbitration rights, including the

right to a stay pending arbitration and an order compelling arbitration, under the Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.* In a number of prior cases, this Court has reviewed and reversed decisions of state courts that held that the Federal Arbitration Act did not require arbitration of a plaintiff's claims and that permitted the case to proceed in the state trial court on the merits. *See, e.g., Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440 (2006); *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995). This Petition for Writ of Certiorari is filed timely pursuant to 28 U.S.C. § 2101(c) and S. Ct. R. 13.1, having been filed within 90 days after the New Mexico Supreme Court entered its May 10, 2007 order quashing its previously-issued writ of certiorari and thereby denying discretionary review of the decision of the New Mexico court of appeals.

STATUTORY PROVISIONS INVOLVED

The Federal Arbitration Act provides, in pertinent part:

> **§ 2. Validity, irrevocability and enforcement of agreements to arbitrate**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and

enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (July 30, 1947, c. 392, 61 Stat. 670).

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (July 30, 1947, c. 392, 61 Stat. 670).

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the

manner provided for in such agreement. Five days notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

9 U.S.C. § 4 (July 30, 1947, c. 392, 61 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233).

STATEMENT OF THE CASE

This case presents issues of exceptional importance under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* ("FAA"). The New Mexico courts in this case have refused to enforce Kinder Morgan's arbitration rights under the FAA. The New Mexico court of appeals' published opinion adopts a restrictive and erroneous approach to application of the presumption favoring arbitration under the FAA in the context of narrow arbitration clauses (an issue that has divided the United States Courts of Appeals and the highest courts of several states). Consistent with its restrictive approach to the presumption in favor of arbitration, the opinion adopts rules governing the determination of arbitrability that (1) allow a court to deny arbitration based on "lack of clarity" in a plaintiff's complaint and a plaintiff's unilateral characterization of its claims, and (2) allow a court to broadly construe exclusionary clauses in arbitration agreements in a manner that eliminates arbitration rights for all contract disputes. The New Mexico court of appeals' decision creates a presumption in favor of court litigation, rather than arbitration, when the arbitration clause is narrow, contrary to the decisions of several of the United States Courts of Appeals and two state supreme courts.

Factual Background

The Bravo Dome Unit ("the Unit") is a carbon dioxide unit located in Northeastern New Mexico. Since January

2000, Kinder Morgan has owned a working interest in the Unit (having acquired its interest from Shell) and has produced and sold carbon dioxide and paid royalties thereon to royalty owners in the Unit. The carbon dioxide produced at the Unit is transported through pipeline and other transportation systems to Permian Basin oil fields in West Texas, where it is sold to oil producers operating there for use in enhanced recovery operations.

Prior to Kinder Morgan's acquisition of its interest in the Unit, a Settlement Agreement was executed in 1998 in connection with a prior class action lawsuit brought by royalty owners against Amoco, Amerada Hess, and Shell, the producers at the Unit at that time. The Settlement Agreement included provisions relating to the methodology for calculating future royalties. That methodology involves calculation by each producer of a volume-weighted-average "net-back" price for that producer's share of carbon dioxide, which is calculated using the sales prices that the producer obtains in its sales of carbon dioxide at the Permian Basin, reduced by charges that the producer incurs to transport the carbon dioxide to the sales points. The resulting "net-back" price is the price on which royalty is to be paid to the royalty owners.[2]

During negotiation of the Settlement Agreement, the parties reviewed the existing sales and transportation agreements, and in the Settlement Agreement, they identified contracts that would be pre-approved by the royalty owners for use in calculating the net-back price and that would not be subject to challenge with regard to future royalty calculations (defined in the Settlement

[2] See Settlement Agreement § 14 (App. 98-102).

Agreement as "Qualified" contracts).[3] It was clear, however, that over time, the producers would enter into new contracts for the sale and transportation of carbon dioxide. Those new contracts were defined in the Settlement Agreement as "Non-Qualified" contracts. Regarding the use of Non-Qualified prices and charges in the "net-back" royalty calculations, the parties agreed as follows:

> Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or approved herein, or that future royalty payments resulting from the use of such benchmarks, are improper. Amoco, Hess, and Shell, on the one hand, and Plaintiffs and members of the Class, on the other, intend, only, to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper.[4]

Having "omit[ted] any agreement" regarding the propriety of Non-Qualified prices and charges utilized in the royalty calculations, the parties established a dispute resolution procedure in the Settlement Agreement for resolving royalty-owner challenges to the propriety of Non-Qualified prices and charges utilized in those calculations – arbitration. The arbitration clause is found in Section 16 of the Settlement Agreement:

> Any claims asserted by Plaintiffs or members of the Class against Amoco, Hess, or Shell *regarding (a) the price or value under Non-Qualified*

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[3] *Id.*

[4] See Settlement Agreement § 14(c) (App. 100).

> *Contracts . . . utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners* and, (b) *regarding Non-Qualified Other Transportation Charges . . . utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding arbitration. . . .* This provision concerning arbitration applies only to the claims identified in this paragraph 16 and shall, in no event, apply to any future claims for breach of this Agreement.

App. 102-103 (emphasis added).

The exclusion from arbitration set out in the last sentence of Section 16 for "future claims for breach of this Agreement" was necessary to insure that a producer could not invoke arbitration in the event it violated express prohibitions in the Settlement Agreement against the use of particular types of deductions in the royalty calculations. For example, Section 9.2 of the Settlement Agreement prohibits deduction of "any costs of Unit Compression, Dehydration, and Gathering" in the royalty calculations. App. 88-89. Section 10 prohibits deduction of a "marketing fee." App. 89-90. Section 11.2 prohibits deduction of mainline transportation greater than certain amounts. App. 92-94. Section 11.4 prohibits deductions for transportation to "the Postle Connection Point." App. 95-96. The exclusionary clause in the last sentence of Section 16 made it clear that the royalty owners would have the right to go back to court in the event a producer deducted a Non-Qualified charge that breached one of these prohibitions in the Settlement Agreement. Because of the exclusionary clause, the producer could not invoke arbitration with regard to such a claim.

Plaintiffs' Claims

On July 26, 2004, Plaintiffs filed a class action arbitration proceeding against Kinder Morgan, invoking the arbitration clause in Section 16 of the Settlement Agreement. A week later, Plaintiffs filed a "Withdrawal" of their arbitration demand and immediately filed this lawsuit in New Mexico state court, asserting the same claims.

The Complaint (App. 27-44) asserts claims for (1) violation of the Unfair Trade Practices Act, (2) constructive fraud, (3) breach of contract and of an alleged implied covenant to act in good faith, (4) breach of an alleged implied covenant to market, and (5) unjust enrichment.[5] The claims are based on allegations that Kinder Morgan has "fabricat[ed]," "attributed," "fixed" or "unilaterally set" prices and charges that are not reflective of the value of the carbon dioxide and that Kinder Morgan did not obtain the best prices reasonably available in its contracts for the sale of carbon dioxide.[6] The challenge to the adequacy of Kinder Morgan's prices for sale of carbon dioxide under contracts that were not pre-approved in the Settlement Agreement (which includes all of Kinder Morgan's new contracts since it was not an interest owner in the Unit at the time of the Settlement Agreement) by definition are claims regarding Non-Qualified prices that fall within the scope of the arbitration clause

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[5] Plaintiffs originally sought certification of a class with regard to each of these claims. However, Plaintiffs subsequently dropped their request for certification of a class with regard to the claims for violation of the New Mexico Unfair Trade Practices Act, constructive fraud, and unjust enrichment. Plaintiffs continue to pursue those claims in their individual capacities.

[6] See, *e.g.*, Complaint §§ 10, 15, 25, 27, 43, 50 (App. 31-41).

in Section 16 of the Settlement Agreement.[7] In fact, in a brief filed in the trial court, Plaintiffs conceded that this case "involves a search for the truth behind the Non-Qualified Contracts. . . ." App. 80. Plaintiffs' claims, challenging the Non-Qualified prices utilized by Kinder Morgan in its royalty calculations, were precisely the type of claims that the parties to the Settlement Agreement agreed to arbitrate in Section 16.

Kinder Morgan's Motion for Stay and to Compel Arbitration

In response to the lawsuit, Kinder Morgan filed a motion to compel arbitration and for a stay pending arbitration under the FAA and the New Mexico arbitration statute. App. 45-65. Kinder Morgan's motion specifically invoked Kinder Morgan's arbitration rights under the FAA. See App. 46 ("Both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act require that Plaintiffs be compelled to arbitrate their claims and that this action be stayed pending arbitration"); App. 52 ("the Federal Arbitration Act applies and requires enforcement of the arbitration clause contained in Section 16 of the Settlement Agreement"); App. 63 ("The FAA and the New Mexico Uniform Arbitration Act mandate that Plaintiffs be compelled to arbitrate, and that this case be stayed pending arbitration").

The trial court denied Kinder Morgan's motion in an order entered on March 11, 2005 (App. 20-21), and Kinder Morgan appealed.

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[7] See Settlement Agreement §§ 14, 14(c), 14(e), 14(f), 14(g), 14(h), 14(i) (App. 98-102).

The Decision of the New Mexico Court of Appeals

On August 8, 2006, the New Mexico court of appeals affirmed the denial of the motion in a reported opinion, *Heimann v. Kinder Morgan CO_2 Company, L.P.*, 140 N.M. 552, 144 P.3d 111 (N.M. Ct. App. 2006), reproduced at App. 1-19, depriving Kinder Morgan of its arbitration rights under the FAA.

In upholding the trial court's denial of arbitration, the New Mexico court of appeals broadly construed the exclusionary clause in the arbitration agreement to exclude from arbitration all contract disputes regarding Non-Qualified prices, holding that the exclusionary clause rendered only non-contract claims potentially subject to arbitration. App. 9-13. The court recognized that the Settlement Agreement permitted the use of prices other than those characterized as "Qualified" and that the parties had expressly stated their intent to "omit any agreement" regarding the propriety of Non-Qualified prices utilized in the royalty calculations. App. 3. The court nevertheless held that the exclusions for "claims for breach" covered the Plaintiffs' attack on Kinder Morgan's use of Non-Qualified prices because the Plaintiffs had characterized certain of their challenges to Kinder Morgan's utilization of Non-Qualified prices as "claims for breach." App. 10, 12-13. The court held that the Plaintiffs' characterization of their claims was controlling and that arbitration therefore was properly denied. App. at 10, 12-13.

The court did not address Kinder Morgan's narrower interpretation of the exclusionary clause. That narrower interpretation was based on (1) the parties' stipulation in Section 14(c) of the Settlement Agreement that they were

"omit[ting] any agreement" concerning the propriety of Non-Qualified prices used in the royalty calculations, establishing that the parties could not have intended a challenge to the propriety of a Non-Qualified price to constitute a "claim for breach of this Agreement" that was excluded from arbitration,[8] and (2) the contractual prohibitions on use of certain types of deductions in the royalty calculations, such as the prohibitions found in Sections 9.2, 10, 11.2, and 11.4 discussed above, violation of which would give rise to a "claim for breach" that would not be arbitrable by virtue of the exclusionary clause in the last sentence of Section 16.[9] Rather than address Kinder Morgan's narrower interpretation of the exclusionary clause as covering only claims for violation of the contractual prohibitions in the Settlement Agreement, the court of appeals simply held that the Plaintiffs' characterization of their claims as claims for "breach" of the Settlement Agreement was controlling. App. 10, 12-13. As a result, the court of appeals refused to order arbitration of the very type of claims that the arbitration clause was intended to cover.

The court of appeals recognized that the exclusionary clause was inapplicable to Plaintiffs' non-contract claims but it nevertheless denied arbitration of those claims as well, based on a "lack of clarity" in the Plaintiffs' Complaint. The court noted that the Complaint could be construed to assert arbitrable claims, but it held that the allegations were "not clear," and based on that "lack of clarity," it held that the trial court had properly denied

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[8] See Settlement Agreement § 14(c) (App. 100).

[9] App. 88-89, 92-96.

arbitration and that the proceedings should continue in the trial court unless and until it becomes "clear" that the claims are arbitrable. App. 15-19. The court therefore resolved doubts regarding arbitrability in favor of court litigation instead of arbitration, contrary to the federal presumption in favor of arbitration under the FAA that requires that doubts be resolved in favor of arbitration. In so holding, the court adopted a rule that rewards vague and artful pleading designed to avoid arbitration rights. In permitting the trial court proceedings to go forward, the court of appeals deprived Kinder Morgan of one of the key advantages to arbitration that underlies the federal policy favoring arbitration – avoidance of expansive and expensive discovery that is unavailable in arbitration.

All of the court of appeals' rulings flowed from its restrictive and erroneous view of the role of the presumption favoring arbitration in the context of a narrow arbitration clause.

Kinder Morgan's Petition for Review by the New Mexico Supreme Court

Kinder Morgan filed a petition for writ of certiorari in the New Mexico Supreme Court, which was granted in October 2006. See App. 22-23. However, after oral argument was held on May 7, 2007, the New Mexico Supreme Court entered an order quashing the writ of certiorari. See App. 24-26. Pursuant to that order, the case has now been remanded to the trial court for further proceedings on the merits.

REASONS FOR GRANTING THE WRIT

I. This Case Presents an Important Issue Regarding Application of the Presumption Favoring Arbitration to Narrow Arbitration Clauses That Has Divided the Circuit Courts of Appeals and the State Supreme Courts.

This Court has held that under the Federal Arbitration Act, there is a strong federal policy favoring arbitration, giving rise to a presumption in favor of arbitration requiring that all doubts regarding the arbitrability of claims be resolved in favor of arbitration. *Moses H. Cone Memorial Hospital v. Mercury Const. Corp.*, 460 U.S. 1, 24-25 (1983) ("The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."); *Mitsubishi Motors Corp. v. Soler-Chrylser Plymouth, Inc.*, 473 U.S. 614, 626 (1985) (quoting the *Moses H. Cone* rule and stating that "the parties' intentions control, but those intentions are generously construed as to issues of arbitrability").

A hotly debated issue in this case from inception has been the extent to which the presumption favoring arbitration applies to a narrow arbitration clause. That is an issue that has divided the United States Courts of Appeals and several state supreme courts.

A. The Circuit Courts of Appeals and the State Supreme Courts Are Sharply Divided on Whether the Presumption Favoring Arbitration Is Less Applicable or Equally Applicable to Narrow Arbitration Clauses as Compared to Broad Arbitration Clauses.

The Second,[10] Third,[11] Sixth,[12] Eighth,[13] and Tenth[14] Circuit Courts of Appeal and the Massachusetts Supreme

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[10] *Louis Dreyfus Negoce S.A. v. Blystad Shipping and Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001) ("[I]f reviewing a narrow clause, the court must determine whether the dispute is over an issue that 'is on its face within the purview of the clause. . . . ' Where the arbitration clause is broad, 'there arises a presumption of arbitrability.' ") (citations omitted).

[11] *Trap Rock Industries Inc. v. Local 825, Intern. Union of Operating Engineers, AFL-CIO*, 982 F.3d 884, 888 n. 5 (3d Cir. 1992) ("Because the arbitration provision . . . is narrowly crafted to apply to only certain disciplinary discharges and layoffs, . . . the presumption of arbitrability . . . [is] inapposite"); *Local 827, Intern. Broth. of Elec. Workers, AFL-CIO v. Verizon New Jersey, Inc.*, 458 F.3d 305, 310-311 (3d Cir. 2006) (same).

[12] *Simon v. Pfizer Inc.*, 398 F.3d 765, 775 (6th Cir. 2005) ("This Court has drawn a clear line between the extensive applicability of general arbitration provisions and the more narrow applicability of arbitration clauses tied to specific disputes. When faced with a broad arbitration clause, such as one covering *any* dispute arising out of an agreement, a court should follow the presumption of arbitration and resolve doubts in favor of arbitration.") (emphasis in original).

[13] *Twin City Monorail, Inc. v. Robbins & Myers, Inc.*, 728 F.2d 1069, 1072-1073 & nn. 3, 4 (8th Cir. 1984) (if an arbitration clause is narrow, the arbitrability determination requires inquiry into whether the claim is "on its face within the purview of the clause").

[14] *Cummings v. FedEx Ground*, 404 F.3d 1258, 1262 (10th Cir. 2005) ("When an arbitration clause is narrowly drawn, the policy in favor of arbitration does not have the 'strong effect here that it would have if we were construing a broad arbitration clause.' . . . Under a narrow arbitration clause, a dispute is subject to arbitration only if it relates to an issue that is on its face within the purview of the clause.") (citations omitted).

Court[15] have held that the presumption favoring arbitration is less applicable to a narrow arbitration clause than to a broad arbitration clause. Several of those courts have said that if the arbitration clause is narrow, a claim must *on its face* fall within the purview of the arbitration clause to require an order compelling arbitration of the claim.[16] Contrary to those decisions, the Fifth,[17] Eleventh,[18] and D.C. Circuit Courts of Appeal,[19] a district court in the

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[15] *Local Union No. 1710, Intern. Ass'n of Fire Fighters, AFL-CIO v. City of Chicopee*, 430 Mass. 417, 721 N.E.2d 378, 382 (1999) ("where the arbitration clause is not broad, courts must be *sure* that the parties contracted to arbitrate the issue at hand") (emphasis added).

[16] See, *e.g.*, the Second Circuit, Eighth Circuit, and Tenth Circuit decisions cited in footnotes 10, 13, and 14, *supra*.

[17] *Intern. Brotherhood of Elec. Workers, Local 2188 v. Western Electric Co., Inc.*, 661 F.2d 514, 516 n. 3 (5th Cir. 1981) ("[T]he [Supreme] Court has never indicated, in its statement of the rule, that the presumption [in favor of arbitration] is limited to such broad clauses. . . . Such a limitation would render the presumption of little value as a rule of construction: we would first have to determine that the arbitration clause is 'broad' enough to cover all contractual disputes, and only then apply the presumption (when it is no longer needed). Moreover, this court has consistently applied the presumption to arbitration clauses of varying breadth. . . . [I]n determining whether a dispute is within the confines of the arbitration clause, the presumption of arbitrability applies, regardless of whether one party characterizes the clause as 'narrow.' ") (citations omitted).

[18] *Ivax Corp. v. B. Braun of Am., Inc.*, 286 F.3d 1309, 1320 n. 23 (11th Cir. 2002) (rejecting argument that presumption in favor of arbitration applies only to broad arbitration clauses and does not apply to narrow arbitration clauses, stating that "the Court in *Moses Cone* made no such distinction, but rather, grounded its preference for arbitration in the "congressional declaration [in the FAA] of a liberal federal policy favoring arbitration agreements.").

[19] *Washington Mailers Union No. 29 v. Washington Post Co.*, 233 F.3d 587, 592 n. 4 (D.C. Cir. 2000) ("The Post argues that the presumption cases are inapplicable because they involve the construction of a 'broad' arbitration clause. We disagree. While the fact that the

(Continued on following page)

Ninth Circuit,[20] the Alaska Supreme Court,[21] and the Texas Supreme Court[22] draw no distinction between narrow and broad arbitration clauses in applying the presumption in favor of arbitration, holding that any doubts concerning arbitrability must be resolved in favor of arbitration, regardless of the scope of the clause. The New Jersey Supreme Court has taken note of the split among the circuits on the issue but held that the case before it did not require a decision on the issue.[23]

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arbitration clause in this case is not broad – limiting grievances to allegations of 'violation of a specific provision of this Agreement' – is relevant to our inquiry, it does not negate the presumption of arbitrability.") (citing *Western Electric*, 661 F.2d at 516 n. 3).

[20] *PNI, Inc. v. Leyton*, 2004 WL 555249, *3, 5 (D. Or. March 1, 2004) ("Whether the arbitration clause is broad or narrow . . . do[es] not answer the core question presented. In interpreting the . . . agreement, the court is guided by the well-established principle, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . .").

[21] *Lexington Marketing Group, Inc. v. Goldbelt Eagle, LLC*, 157 P.3d 470, 478 (Alaska 2007) (applying presumption in favor of arbitration, "regardless of whether the clause is narrow or broad.").

[22] *In re Dillard Dept. Stores*, 186 S.W.3d 514, 516 (Tex. 2006) (construing narrow arbitration clause to cover plaintiff's claims, stating that "[a] court should not deny arbitration 'unless it can be said with positive assurance that an arbitration clause is not susceptible of an interpretation which would cover the dispute at issue' . . . [and] the agreement is susceptible to an interpretation that includes Martinez's claim. Therefore, the trial court was required to compel arbitration.").

[23] *Camden Bd. of Educ. v. Alexander*, 181 N.J. 187, 854 A.2d 342 (2004). The majority opinion in this case said, "Although not necessary to our disposition, we mention only that several courts in jurisdictions that do apply the presumption in favor of arbitration from the 'Steelworkers Trilogy' have not applied the presumption to narrow arbitration clauses." 854 A.2d at 355 n. 10. The dissenting judge in this case would have held that the presumption in favor of arbitration applies to narrow clauses, stating: "Even if this arbitration clause is labeled 'narrow,' however, the presumption of arbitrability still applies. As the

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In this case, the New Mexico court of appeals adopted the Plaintiffs' argument that the presumption in favor of arbitration is of limited application to a narrow clause. App. 6, 8, 17-18. The court of appeals relied on an earlier New Mexico Supreme Court decision that held that "the arbitration agreement will be given broad interpretation *unless the parties themselves limit arbitration to specific areas or matters.*" App. 6, 8 (quoting *McMillan v. Allstate Indem. Co.*, 135 N.M. 17, 84 P.3d 65, 69 (N.M. 2003) (emphasis added)). The court of appeals also relied on one of the Tenth Circuit cases that has held that "[u]nder a narrow arbitration clause, a dispute is subject to arbitration only if it relates to an issue that is on its face within the purview of the clause." App. 17-18; *Cummings v. FedEx Ground Package Sys., Inc.*, 404 F.3d 1258, 1262 (10th Cir. 2005).

B. The Decision in This Case Illustrates the Error in a Restrictive Approach to the Application of the Presumption Favoring Arbitration to Narrow Arbitration Clauses.

The error in a restrictive approach to application of the presumption favoring arbitration to narrow arbitration clauses is fully illustrated by the New Mexico courts' disposition of Kinder Morgan's arbitration motion. Even though the court of appeals determined that the Plaintiffs'

Fifth Circuit has explained, applying the presumption of arbitrability only to broad arbitration clauses 'would render the presumption of little value as a rule of construction: we would first have to determine that the arbitration clause is "broad" enough to cover all contractual disputes, and only then apply the presumption (when it is no longer needed).'" 854 A.2d at 373 (Zazzali, J., dissenting) (quoting *Western Electric*, 661 F.2d at 516 n. 3).

Complaint could be reasonably construed to raise arbitrable claims, it denied arbitration of all claims and affirmed the trial court's denial of the motion to compel arbitration with regard to all claims. App. 10-19. The court of appeals reasoned that the limited application of the presumption favoring arbitration in the context of a narrow arbitration clause required that it deny arbitration unless and until it became "clear" that the claims in the Complaint were arbitrable. App. 17-18.

Specifically, the court of appeals noted that the Plaintiffs' allegations on their claim under the New Mexico Unfair Practices Act could be interpreted to allege claims regarding use of Non-Qualified contract prices that are arbitrable, but the court nevertheless denied arbitration, stating that the "Plaintiffs' allegations are very general" and "Plaintiffs' complaint simply does not make clear the facts they intend to prove at trial." App. 15-16. Similarly, on Plaintiffs' fraud claim, the court of appeals "note[d] . . . some language in the complaint [that] seems to indicate that Plaintiffs have decided to challenge the prices under non-qualified contracts" but concluded that "[i]t is unclear which facts Plaintiffs allege in support of this theory and which facts Plaintiffs allege in support of their claims for breach of the settlement agreement. . . ." App. 16. The court also noted that on the Plaintiffs' unjust enrichment claim, "Plaintiffs may indeed be challenging the prices under non-qualified contracts. It is simply not clear." App. 17.

The court ultimately held that "[h]aving concluded that nothing in the complaint *clearly* states whether the claims for violation of the Unfair Practices Act, fraud, and unjust enrichment are based on a dispute over non-qualified contract or transportation prices, . . . [and]

[a]pplying principles of contract interpretation, we conclude that it would be inappropriate to compel arbitration when we have not been able to determine that Plaintiffs raised any claims covered by the arbitration clause." App. 17 (emphasis added). The court "emphasize[d] that [its] decision [was] based on the *lack of clarity* in Plaintiffs' complaint and subsequent statements. . . ." App. 18 (emphasis added).

The manner in which the court resolved the arbitrability issues makes it clear that the court adopted a rule that resolves doubts in favor of court litigation, rather than arbitration. The court of appeals recognized that there were doubts concerning the arbitrability of the Plaintiffs' claims, but it nevertheless resolved those doubts by denying arbitration rather than ordering arbitration. The court of appeals' rationale for denying arbitration is directly contrary to the strong federal policy favoring arbitration that underlies the Federal Arbitration Act, as recognized by this Court in adopting the presumption favoring arbitration requiring that all doubts be resolved in favor of arbitration, not court litigation.

The fact that the court left open the possibility of a later order compelling arbitration of the Unfair Practices Act, fraud, and unjust enrichment claims if it "become[s] clear that prices of non-qualified contracts or transportation charges are issues with respect to" those claims (App. 18-19) does not prevent the impairment of Kinder Morgan's arbitration rights. The federal courts have recognized that "[a]rbitration loses much of its value if one party can force protracted litigation and expensive discovery. . . ." *Virginia Sprinkler Co. v. Local Union 669*, 868 F.2d 116, 121 (4th Cir. 1989). *See also Burton v. Bush*, 614 F.2d 389, 391 (4th Cir. 1980) ("We believe that . . .

[discovery] limitations [in arbitration] are in keeping with the policy underpinnings of arbitration – speed, efficiency, and reduction of litigation expenses"); *Metro East Center for Conditioning and Health v. Qwest Communications Intern., Inc.*, 294 F.3d 924, 927 (7th Cir. 2002) ("the discovery procedures of litigation may be more expensive for both sides than are the procedures used in arbitration"). By forcing Kinder Morgan to engage in expensive court discovery with regard to claims that should be referred to arbitration under the proper application of the presumption favoring arbitration, the court of appeals has deprived Kinder Morgan of one of the significant benefits of the arbitration clause in the Settlement Agreement.

In summary, this case is an appropriate case for resolving the significant conflict in the decisions of the United States Courts of Appeals and the state supreme courts concerning the proper application of the presumption favoring arbitration in the context of narrow arbitration clauses.

II. The New Mexico Court of Appeals' Denial of Arbitration Based on the "Lack of Clarity" in the Plaintiffs' Complaint Conflicts with Circuit Court of Appeals and District Court Decisions That Refuse to Allow Arbitration Rights to be Defeated Based on Vague or Artful Pleadings.

As discussed above, the New Mexico court of appeals denied arbitration of some of Plaintiffs' claims only because the Plaintiffs' allegations were "general" and "not clear." App. 14-19. The court did not mince words on that conclusion: "We emphasize that our decision is based on

the lack of clarity in Plaintiffs' complaint and subsequent statements. . . ." App. 18.

Unlike the court of appeals in this case, the federal courts uniformly held that a court should not deny arbitration based on a plaintiff's artful pleading or on doubts concerning arbitrability raised by vague allegations in a plaintiff's complaint. *See Brandon, Jones, Sandall, Zeide, Kohn, Chalal & Musso, P.A. v. MedPartners, Inc.*, 312 F.3d 1349, 1358 (11th Cir. 2002) (court compelled arbitration, stating that "[t]o conclude otherwise would allow [plaintiff] to avoid arbitration simply through artful pleading"); *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, 1360 (2d Cir. 1993) ("We refuse to allow a party's solemn promise [in forum selection and arbitration clauses] to be defeated by artful pleading"); *Ivax Corp.*, 286 F.3d at 1318 ("surely parties to an arbitration agreement may not 'evade arbitration through artful pleading' "); *Encore Produc., Inc. v. Promise Keepers*, 53 F.Supp.2d 1101, 1110 (D. Colo. 1999) (though complaint was ambiguous as to arbitrability of claim, arbitration was compelled because "federal policy construes all ambiguities in favor of arbitration"); *Land v. Dean Witter Reynolds, Inc.*, 617 F.Supp. 52, 55 (E. D. Va. 1985) (court compelled arbitration of claim alleged in "vague and conclusory terms," stating that "[a]fter the details of this claim have been fleshed out in arbitration, this count may be referred back to this Court for resolution should the arbitrator determine that this claim is not arbitrable"). The New Mexico court of appeals' denial of arbitration based on the "lack of clarity in Plaintiffs' complaint" directly conflicts with these decisions and will have the effect of exposing defendants in New Mexico (and perhaps other state courts that choose to follow the approach of the New Mexico court of appeals in this reported

decision) to loss of their arbitration rights solely as a result of a plaintiff's vague or artful pleading. Review of this important issue is warranted.

III. Plaintiffs' Characterization of Their Claims as "Breach" Claims Is Not Dispositive of Arbitrability, and the New Mexico Court of Appeals' Decision to the Contrary Conflicts With Decisions of the Fourth and Seventh Circuits.

The court of appeals acknowledged that the contract claims that the Plaintiffs assert in this case are claims regarding Non-Qualified prices that Kinder Morgan used in the calculation of royalties.[24] The court repeatedly said that the Plaintiffs' claims relating to the methodology used to calculate royalties arose out of Kinder Morgan's use of Non-Qualified prices in the calculations.[25] The court also recognized that the Plaintiffs allege that Kinder Morgan failed to contract for "the best price reasonably available" when it entered into contracts for the sale of carbon dioxide produced at the Unit.[26] Having become a working interest owner after the execution of the Settlement Agreement, any such contracts entered into by Kinder Morgan necessarily are Non-Qualified contracts under the

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[24] See App. 4 ("Plaintiffs contend that Kinder Morgan modified the parties' agreed-on methodology for calculating future royalties, by using non-qualified contracts in the royalty calculations. . . ."); App. 5 ("Plaintiffs also argue that the use of non-qualified contracts in calculating royalty payments is in itself a breach of the settlement agreement. . . ."); App. 12 ("Plaintiffs argue that the use of non-qualified contracts in itself constitutes a breach of the settlement agreement.").

[25] *Id.*

[26] *Id.* at 13.

Settlement Agreement, and the Plaintiffs' claims challenging the prices under those contracts are claims regarding Non-Qualified prices. Those claims are precisely the type of claims that the arbitration clause was intended to cover.

Nevertheless, the Plaintiffs characterized their claims as claims for "breach" of the Settlement Agreement, and they argued to the court of appeals that because of that characterization, the claims fall within the exclusionary clause in the arbitration agreement for "future claims for breach of this Agreement." In response, Kinder Morgan pointed out that the Plaintiffs' proposed interpretation of the exclusionary clause left no disputes regarding the calculation of royalties arbitrable, because the Plaintiffs characterized any use of Non-Qualified prices in the royalty calculations as a "breach" falling within the exclusionary clause. Kinder Morgan offered a narrower interpretation of the exclusionary clause, which is described in the Statement of the Case section of this Petition. Under that interpretation, the "claims for breach of this Agreement" referenced in the exclusionary clause in the last sentence of Section 16 relates to claims for breach of the provisions in the Settlement Agreement that prohibited the use of certain types of deductions in the royalty calculations, such as those found in Sections 9.2, 10, 11.2, and 11.4, but would not include claims based on the use of Non-Qualified prices and charges falling outside those prohibitions, as the parties stipulated that they were "omit[ting] any agreement" with regard to the use of such prices and charges in Section 14(c) of the Settlement Agreement. The parties, having stipulated in the Settlement Agreement that they were "omit[ting] any agreement" concerning the use of Non-Qualified prices, could not have intended that the use of such prices would constitute a "breach" of the

Settlement Agreement for the purposes of the exclusionary clause in the last sentence of the arbitration agreement in Section 16.

The court of appeals did not address that narrower interpretation of the exclusionary clause. Instead, the court held that the Plaintiffs' characterization of its claims as "claims for breach" was controlling on the arbitrability determination. The court said that "when, as here, the arbitration clause has an explicit exception for certain types of claims, we must consider the causes of action Plaintiffs rely on." App. 10. The court noted that "Plaintiffs argue that the use of non-qualified contracts in itself constitutes a breach of the settlement agreement," that the third count in the Complaint "alleges breach of the settlement agreement," and "[i]t therefore, is not subject to arbitration." App. 12-13. With regard to the fourth count in the Complaint, alleging failure to obtain the best price reasonably available, the court noted that Plaintiffs "allege breach of the settlement agreement" and held that therefore, "[t]his claim, as stated in Plaintiffs' complaint, is not subject to arbitration." App. 13. The court made no inquiry to determine whether the nature of the claim was of the type that the parties intended to exclude from arbitration, but found the Plaintiffs' characterization of the claims as "claims for breach" to be determinative.

This approach to determining arbitrability conflicts with decisions of the Seventh and Fourth Circuits. In *In re Oil Spill by Amoco Cadiz*, 659 F.2d 789, 794 (7th Cir. 1981) the Seventh Circuit rejected the plaintiff's argument that arbitrability should turn on the plaintiff's characterization of its claims, stating that "[w]hether a particular claim is arbitrable depends not upon the characterization of the claim, but upon the relationship of the claim to the

subject matter of the arbitration clause. Were the rule otherwise, a party could frustrate any agreement to arbitrate simply by the manner in which it framed its claims." Similarly, the Fourth Circuit has said that in determining arbitrability, a court "must determine whether the factual allegations underlying the claim are within the scope of the arbitration clause, *regardless of the legal label assigned to the claim*." *J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, 319 (4th Cir. 1988) (emphasis added). The court of appeals in this case applied a contrary rule. Because the court of appeals has announced a rule relating to the determination of arbitrability that conflicts with the rules announced in the Seventh Circuit's decision in *Amoco Cadiz* and the Fourth Circuit's decision in *J.J. Ryan*, review is warranted.

IV. The New Mexico Court of Appeals Failed to Construe the Exclusionary Clause in the Settlement Agreement Narrowly, Contrary to Fourth Circuit Precedent.

The court of appeals' approach to the interpretation of an exclusionary clause in an arbitration agreement directly conflicts with the Fourth Circuit's approach to that same issue in *Choice Hotels Intern. Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707, 711 (4th Cir. 2001). In *Choice Hotels*, the exclusionary clause excluded from arbitration "actions for the collection of money owed under this Agreement." 252 F.3d at 710. The plaintiff argued that this exclusionary clause covered all claims seeking monetary damages. *Id.* at 711. While recognizing that the plaintiff's broad interpretation was plausible, the Fourth Circuit adopted a narrow construction of the language, limiting the exclusion to "traditional collection actions." *Id.* In so

holding, the court relied on (1) the "federal policy requir[ing] that ambiguities in arbitration clauses be resolved in favor of arbitration," (2) the rule that the "policy favoring broad construction of arbitration clauses compels narrow construction of exceptions to arbitration clauses," and (3) the rule requiring that exceptions to arbitration be narrowly construed "lest they overwhelm the rule." *Id.* The Fourth Circuit noted that under the plaintiff's interpretation, no claims for money under the contract would be arbitrable, even though the description of arbitrable claims (considered without reference to the exclusion) clearly included such claims. *Id.*

The court of appeals in this case took precisely the opposite approach to construction of the exclusionary clause. The court of appeals ignored Kinder Morgan's proposed narrower interpretation of the exclusionary clause, *i.e.*, that the exclusion for "future claims for breach of this Agreement" referred to claims for violation of the prohibitions on use of certain types of charges in the calculations. Kinder Morgan presented a reasonable, narrower interpretation of the exclusionary clause, but the New Mexico court of appeals ignored that interpretation and instead, it interpreted the exclusionary clause as broadly as possible. The court of appeals' interpretation of the exclusionary clause results in the exclusionary clause overwhelming the arbitration clause, leaving no disputes regarding the calculation of the royalties arbitrable, precisely the result that the Fourth Circuit found improper in *Choice Hotels*.

This issue and the other issues that this petition raises flow from the court of appeals' refusal to broadly apply the presumption favoring arbitration to the arbitration clause in the Settlement Agreement. Review of this

case is warranted to eliminate the confusion that currently exists in the United States Court of Appeals and the state courts over the proper application of the presumption favoring arbitration in determining arbitrability under a narrow arbitration clause and to avoid the impairment of arbitration rights that will occur if arbitrability decisions are allowed to turn on a plaintiff's vague and artful pleading and its unilateral characterization of its claims.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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144 P.3d 111

Court of Appeals of New Mexico.
J. Casper **HEIMANN**, Pecos Slope Royalty Trust and Rio Petro Ltd., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated, Plaintiffs-Appellees,
v.
KINDER-MORGAN CO2 COMPANY, L.P., Defendant-Appellant.
No. 25,735.

Aug. 8, 2006.
Certiorari Granted, No. 29,990, Oct. 11, 2006.

Gallegos Law Firm, P.C., J.E. Gallegos, Michael J. Condon, Santa Fe, NM, Susman Godfrey, LLC, Thomas W. Paterson, Shawn Raymond, Houston, TX, for Appellees.

Long, Pound & Komer, P.A., John B. Pound, Santa Fe, NM, Vinson & Elkins L.L.P., Guy S. Lipe, Andrew McCollam, III, Richard H. Page, Houston, TX, for Appellant.

OPINION

WECHSLER, Judge.

{1} In this case we determine the scope of an arbitration clause contained in a 1998 settlement agreement between Plaintiffs, a class of carbon dioxide royalty owners, and Defendant, Kinder Morgan CO2 Company, L.P., a working interest owner. Kinder Morgan appeals a district court order denying its motion to compel arbitration. We entertain this appeal pursuant to NMSA 1978, § 44-7-19(A)(1) (1971) (repealed 2001) (current version at NMSA 1978, § 44-7A-29(a)(1) (2001)), and we affirm.

BACKGROUND

{2} Plaintiffs own royalties in the Bravo Dome Carbon Dioxide Unit, a carbon dioxide producing unit in northeastern New Mexico, based on their fee ownership of the land. Carbon dioxide is transported by Kinder Morgan from the Unit to oil fields, where it is used to aid in the production of oil. Kinder Morgan uses some of the carbon dioxide it produces at the Unit in its own oil operations and sells the rest to other oil companies. It pays royalties to Plaintiffs based on the sales for the carbon dioxide it produces at the Unit.

{3} In 1995, Plaintiffs filed a lawsuit against the Unit's carbon dioxide producers, including Shell Western E & P Inc. and Shell CO2 Company, Kinder Morgan's predecessors-in-interest, for royalties they claimed had been underpaid. Plaintiffs and Shell settled the lawsuit in 1998. Plaintiffs filed this lawsuit against Kinder Morgan in August 2004, claiming violations of the Unfair Practices Act, constructive fraud, breach of the settlement agreement, breach of the implied covenant of good faith, breach of a covenant to market, and unjust enrichment, and requesting an accounting, injunctive relief, compensatory and punitive damages, interest, and attorney fees and costs. In its answer and a subsequent motion to compel arbitration, Kinder Morgan argued that each of these claims was subject to an arbitration clause contained in the 1998 settlement agreement. The parties agree that the arbitration clause is valid, but dispute its proper scope.

{4} The 1998 settlement agreement contained numerous provisions governing the method by which future royalties would be calculated. It provided that Shell would pay royalties based on "the volume weighted average of the

prices for [its] sales or other dispositions of Unit CO2 that [it] separately dispose[s] of or take[s] in kind." This volume weighted average would be calculated "utilizing a net-back methodology to adjust [Shell's] prices for sales or other dispositions occurring downstream of the Unit Tailgate, and utilizing the prices or values established in [its] Qualified Contracts . . . , [its] transportation charges established as Qualified Other Transportation Charges . . . , and [its] Approved Mainline Deductions." The settlement agreement further provided that other methodology might be used:

> Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or approved herein, or that future royalty payments resulting from the use of such benchmarks, are improper. [Shell], on the one hand, and Plaintiffs and members of the Class, on the other, intend, only, to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper.

(5) The arbitration clause in the settlement agreement applies to disputes involving non-qualified contracts and non-qualified transportation charges. "Non-qualified" contracts and charges, as defined by the settlement agreement, are new contracts or arrangements not pre-approved by the royalty owners. The arbitration clause states:

> Any claims asserted by Plaintiffs or members of the Class against . . . Shell regarding (a) the price or value under Non-Qualified Contracts . . . utilized by . . . Shell in establishing royalty settlement values for purposes of payment to their

> Respective Owners and, (b) regarding Non-Qualified Other Transportation Charges . . . utilized by . . . Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding arbitration. . . . This provision concerning arbitration applies only to the claims identified in this paragraph . . . and shall, in no event, apply to any future claims for breach of this Agreement.

{6} Kinder Morgan filed a motion to compel arbitration on each issue in this case. At a hearing on February 24, 2005, the district court ruled that the claims alleged involved breach of contract and were therefore not subject to the arbitration clause. It entered an order denying Kinder Morgan's motion in March 2005.

ARGUMENTS ON APPEAL

{7} Kinder Morgan argues that the district court erred in denying its motion to compel arbitration. Because Plaintiffs contend that Kinder Morgan modified the parties' agreed-on methodology for calculating future royalties, by using non-qualified contracts in the royalty calculations and by failing to disclose that use to Plaintiffs, Kinder Morgan argues that underlying Plaintiffs' claims is the contention that the price of non-qualified contracts was improper. Thus, according to Kinder Morgan, all of Plaintiffs' claims are subject to arbitration. Although the complaint is largely couched in terms of breach of contract, it also contains language that Kinder Morgan argues shows that the claims fall within the scope of the arbitration clause, such as the following:

> 10. . . . The defendant has engaged in across the board methods of fabricating prices and fixing self serving false values for the Unit CO2. . . .
>
> . . . .
>
> 25. . . . Small quantities of the CO2 from the Unit are some times [sic] the subject of pretextual "bid" arrangements resulting in a sales contract reciting a "price" per Mcf of CO2 delivered at a Permian Basin oil field. Some Unit working interest owners have cited such "prices" as a basis for valuing CO2 produced at the Unit. . . .
>
> . . . .
>
> 43. Kinder-Morgan has for the material time uniformally [sic] set "prices" that are not formed by true market forces, are grossly less than the value relative to the oil and other hydrocarbons that but for the CO2 would not be recovered and are fixed by the defendant to serve its objectives of (a) reducing expense and (b) maximizing its profit. . . .

Kinder Morgan correctly notes that ambiguity in arbitration clauses should be resolved to favor arbitration. *E.g., DeArmond v. Halliburton Energy Servs., Inc.*, 2003-NMCA-148, ¶ 7, 134 N.M. 630, 81 P.3d 573.

{8} Plaintiffs argue that in order to invoke the arbitration clause, Kinder Morgan must give prior notice of its intention to use non-qualified contracts in its royalty calculation. Their contention is that once notice had been given, and royalty owners had objected, Kinder Morgan could then have invoked the arbitration clause. Plaintiffs also argue that the use of non-qualified contracts in calculating royalty payments is in itself a breach of the settlement agreement that would fit within the explicit exception to

the arbitration clause for claims for breach of the settlement agreement. Thus, they argue, none of their claims is subject to arbitration. Finally, Plaintiffs note that the arbitration clause is narrow and should not be bound by the general policy in favor of arbitrability. *See, e.g., New York v. Oneida Indian Nation of N.Y.,* 90 F.3d 58, 61-63 (2d Cir.1996).

STANDARD OF REVIEW

{9} We review de novo the district court's denial of Kinder Morgan's arbitration demand. *Piano v. Premier Distrib. Co.,* 2005-NMCA-018, ¶ 4, 137 N.M. 57, 107 P.3d 11. Interpretation of the arbitration clause in the settlement agreement is also a question of law subject to de novo review. *W. Farm Bureau Ins. Co. v. Carter,* 1999-NMSC-012, ¶ 4, 127 N.M. 186, 979 P.2d 231.

ARBITRATION

{10} We first address the parties' claims and note that both seem to have taken somewhat unreasonable positions. On the one hand, Kinder Morgan's position would require arbitration of all claims that involve non-qualified contracts or transportation charges. Its interpretation of the arbitration agreement would leave essentially no viable claims that would not be subject to arbitration, despite the fact that the arbitration clause is narrow and explicitly excludes claims for breach of the settlement agreement. On the other hand, Plaintiffs' position allows arbitration only when Kinder Morgan has followed specific procedures that do not appear within the settlement agreement. We will not read language into a contract that is not there, but neither will we construe any clause so as

to render it meaningless. *See Pub. Serv. Co. of N.M. v. Diamond D Constr. Co.*, 2001-NMCA-082, ¶ 31, 131 N.M. 100, 33 P.3d 651; *cf. Twin Forks Ranch, Inc. v. Brooks*, 1998-NMCA-129, ¶ 20, 125 N.M. 674, 964 P.2d 838 (noting that courts cannot reform a contract to add terms not agreed upon by the parties). We accordingly reject both parties' positions.

{11} The parties agree that we ought not look beyond the language of the complaint to determine whether Plaintiffs' claims are subject to arbitration. However, both parties present arguments on appeal that are based on statements made subsequent to the filing of the complaint. We reach the same conclusion regardless of whether we consider these statements.

{12} Despite Kinder Morgan's suggestion that the claim for breach of the settlement agreement is not legitimate, we will not consider the validity of claims stated.

> [I]n deciding whether the parties have agreed to submit a particular grievance to arbitration, a court is not to rule on the potential merits of the underlying claims. Whether "arguable" or not, indeed even if it appears to the court to be frivolous, the . . . claim . . . is to be decided, not by the court asked to order arbitration, but as the parties have agreed, by the arbitrator. "The courts, therefore, have no business weighing the merits of the grievance, considering whether there is equity in a particular claim, or determining whether there is particular language in the written instrument which will support the claim. The agreement is to submit all grievances to arbitration, not merely those which the court will deem meritorious."

AT & T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 649-50, 106 S.Ct. 1415, 89 L.Ed.2d 648 (1986) (citation omitted). Thus, we decline to express any opinion as to the merits of Plaintiffs' claims as stated. This issue is not before us.

{13} Both the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (2000), and the New Mexico Uniform Arbitration Act, NMSA 1978, §§ 44-7-1 to -22 (1971) (repealed 2001) (current version at NMSA 1978, §§ 44-7A-1 to -32 (2001)), express a strong presumption in favor of arbitrability. *See, e.g., McMillan v. Allstate Indem. Co.*, 2004-NMSC-002, ¶ 9, 135 N.M. 17, 84 P.3d 65; *Heye v. Am. Golf Corp.*, 2003-NMCA-138, ¶ 8, 134 N.M. 558, 80 P.3d 495. However, we agree with Plaintiffs that only matters falling under the scope of a narrow arbitration clause require arbitration. *See McMillan*, 2004-NMSC-002, ¶ 10, 135 N.M. 17, 84 P.3d 65 ("[T]he arbitration agreement will be given broad interpretation unless the parties themselves limit arbitration to specific areas or matters.") (internal quotation marks and citation omitted); *cf. AT & T Techs., Inc.*, 475 U.S. at 650, 106 S.Ct. 1415 (noting that the presumption in favor of arbitration, the rule that "[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute," is "particularly applicable" when the arbitration clause at issue is broad) (alteration in original) (internal quotation marks and citation omitted). The presumption does not operate to create a right to arbitrate claims the parties have not agreed to arbitrate. *See Santa Fe Techs., Inc. v. Argus Networks, Inc.*, 2002-NMCA-030, ¶¶ 52-57, 131 N.M. 772, 42 P.3d 1221 (noting that "the court's inquiry is whether the parties have agreed to

arbitrate the matter under dispute" and holding that the arbitration clause in that case, though broad, was not broad enough to encompass the claim); *see also AT & T Techs., Inc.,* 475 U.S. at 648-49, 106 S.Ct. 1415 ("[A]rbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration."). We "give effect to the intent of the parties, and when the terms of the agreement are clear and unambiguous, courts try to ascertain the intent of the parties from the ordinary meaning of the language in the agreement." *Cont'l Potash, Inc. v. Freeport-McMoran, Inc.,* 115 N.M. 690, 704, 858 P.2d 66, 80 (1993).

{14} Under the arbitration clause in this case, the parties agreed to submit to arbitration only those claims regarding the prices of non-qualified contracts and transportation charges. Language in the settlement agreement emphasizes the narrow scope of the arbitration clause: "This provision concerning arbitration applies only to the claims identified in this paragraph. . . ." It also provides an explicit exception for "any future claims for breach of this Agreement." "Courts must interpret the provisions of an arbitration agreement according to the rules of contract law and apply the plain meaning of the contract language in order to give effect to the parties' agreement." *McMillan,* 2004-NMSC-002, ¶ 10, 135 N.M. 17, 84 P.3d 65. We therefore turn first to the question of breach of the settlement agreement, because claims for breach are not subject to arbitration regardless of whether they may involve prices of non-qualified contracts. Then, we will discuss whether other claims in the complaint should be subject to the arbitration clause.

EXCEPTION FOR BREACH OF THE SETTLEMENT AGREEMENT

{15} Ordinarily we look to the facts alleged in a complaint to determine whether claims are subject to arbitration. *See Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 846 (2d Cir.1987) ("In determining whether a particular claim falls within the scope of the parties' arbitration agreement, we focus on the factual allegations in the complaint rather than the legal causes of action asserted."). But when, as here, the arbitration clause has an explicit exception for certain types of claims, we must consider the causes of action Plaintiffs rely on. The settlement agreement states that no claims for breach of the settlement agreement are subject to arbitration, and we must examine the complaint to give effect to the intent of the parties. *See Shaeffer v. Kelton*, 95 N.M. 182, 185, 619 P.2d 1226, 1229 (1980) ("The primary objective in construing a contract is not to label it with specific definitions or to look at form above substance, but to ascertain and enforce the intent of the parties as shown by the contents of the instrument."). Claims for breach of contract are necessarily claims for breach of the settlement agreement, because that agreement is the only contract between the parties. We therefore examine the facts underlying each of Plaintiffs' claims to determine what claim, if any, they state, and whether that claim falls within the exception.

{16} Plaintiffs' first claim alleges violation of New Mexico's Unfair Practices Act. NMSA 1978, §§ 57-12-1 to -24 (1967, as amended through 2005). In order to state a claim for unconscionable trade practices, a plaintiff may allege that the defendant took advantage of the plaintiff's "lack of knowledge . . . to a grossly unfair degree" to the plaintiff's detriment, or that action of the defendant "result[ed]

in a gross disparity between the value received by [the plaintiff] and the price paid." Section 57-12-2(E). Plaintiffs' complaint alleges that Kinder Morgan "has taken advantage of the lack of knowledge of the plaintiffs to a grossly unfair degree and paid the Royalty Interests in an amount grossly less than the proper and real value." Plaintiffs must also allege that this practice occurred "in connection with the sale, lease, rental or loan, or in connection with the offering for sale, lease, rental or loan, of any goods or services." *Id.* As we have noted, the entire complaint arises from the lease and sale of carbon dioxide. Violation of the Act is not a breach of contract, as evidenced by Section 57-12-10(D), which provides for relief "in addition to remedies otherwise available." This claim does not, therefore, fit within the explicit exclusion for claims of breach of the settlement agreement.

{17} Plaintiffs' complaint next alleges fraud. To state a claim for fraud, plaintiffs must allege

> that a representation was made as a statement of fact which was untrue and known to be untrue by the party making it, or else recklessly made; that it was made with intent to deceive and for the purpose of inducing the other party to act upon it; and that the other party did in fact rely on it and was induced thereby to act to his injury or damage.

Sauter v. St. Michael's Coll., 70 N.M. 380, 384-85, 374 P.2d 134, 138 (1962). Fraud may also be premised on an omission if there is a duty to disclose information, such as when the defendant has superior knowledge. *Azar v. Prudential Ins. Co. of Am.*, 2003-NMCA-062, ¶ 60, 133 N.M. 669, 68 P.3d 909. Plaintiffs allege fraud by claiming that Kinder Morgan had "superior and important knowledge concerning

the CO2 economics and uses available only to it," that Kinder Morgan failed to "disclose completely and truthfully all material facts," that Kinder Morgan did so intentionally, and that Kinder Morgan's failure to disclose "has proximately caused damages to the plaintiffs." Fraud is a tort, rather than a breach of contract, claim and is therefore potentially subject to the arbitration agreement. *See Williams v. Stewart,* 2005-NMCA-061, ¶ 36, 137 N.M. 420, 112 P.3d 281 (noting and distinguishing "breach of contract" and "the tort of fraud" as two separate causes of action).

{18} The complaint alleges "breach of contract and of the covenant of good faith and fair dealing" as its third claim. We turn to the facts alleged to determine whether this claim is actually for breach of the settlement agreement, and conclude that it is. The claim of breach of good faith and fair dealing sounds in contract, at least when no "special relationship" such as that between an insured and insurer exists. *Bourgeous v. Horizon Healthcare Corp.,* 117 N.M. 434, 439, 872 P.2d 852, 857 (1994). This concept allows courts to award damages for breach of contract when one party prevents another from getting the benefits of a contractual arrangement. *Id.* at 438, 872 P.2d at 856. Plaintiffs' complaint alleges that Kinder Morgan interfered with their right to payment under the settlement agreement insofar as Kinder Morgan "intentionally to cause damage" calculated royalty payments using prices that are "not formed by true market forces." On appeal, Plaintiffs argue that the use of non-qualified contracts in itself constitutes a breach of the settlement agreement. We reiterate that it is not our task to decide the merits of this claim, but rather to determine whether it falls within the exception to the arbitration clause in the settlement

agreement. As stated in the complaint and on appeal, Plaintiffs' third claim alleges breach of the settlement agreement. It, therefore, is not subject to arbitration.

{19} Plaintiffs' fourth claim is for breach of an implied covenant to market. Implied covenants are enforced by courts when "it is clear . . . from the relevant parts of the contract taken together and considered with the facts and circumstances surrounding the execution of the agreement, that the obligation in question was within the contemplation of the parties or was necessary to effect their intention." *Cont'l Potash, Inc.,* 115 N.M. at 704, 858 P.2d at 80; *see Darr v. Eldridge,* 66 N.M. 260, 264, 346 P.2d 1041, 1044 (1959) (noting that "equity demands that the covenant to market be implied in oil and gas leases"). Plaintiffs allege that Kinder Morgan is subject to an implied covenant "to achieve the best price or value for CO2 produced from the Unit reasonably possible under the circumstances." They further allege that Kinder Morgan breached that covenant by failing to "derive the best prices reasonably available." Plaintiffs thus allege breach of the settlement agreement in their fourth claim. This claim, as stated in Plaintiffs' complaint, is not subject to arbitration.

{20} The fifth claim in Plaintiffs' complaint requests an accounting, an injunction, and damages for unjust enrichment. An accounting and an injunction are remedies only and do not constitute independent claims for the purpose of this analysis. Unjust enrichment, however, is a theory under which an aggrieved party may recover from another party who has profited at the expense of the aggrieved party. *Ontiveros Insulation Co. v. Sanchez,* 2000-NMCA-051, ¶ 11, 129 N.M. 200, 3 P.3d 695. In order to state a claim for unjust enrichment, the aggrieved party must allege "that: (1) another has been knowingly benefitted at

one's expense (2) in a manner such that allowance of the other to retain the benefit would be unjust." *Id.* Plaintiffs in this case allege unjust enrichment by claiming that Kinder Morgan "has willfully and in violation of duties imposed by law and equity failed and continues to fail to fairly share the true economic benefit of the CO2 produced from the Unit." However, it is not clear whether a claim for unjust enrichment is a claim for breach of the settlement agreement that is excluded from the arbitration requirement. Our Supreme Court has said that "an action for unjust enrichment is not 'based on contract' in a strict theoretical sense," but that it is sufficiently closely related to a contract claim that it ought to be subject to the same sovereign immunity requirements. *Hydro Conduit Corp. v. Kemble,* 110 N.M. 173, 179, 793 P.2d 855, 861 (1990); *see also Tom Growney Equip., Inc. v. Ansley,* 119 N.M. 110, 112, 888 P.2d 992, 994 (Ct.App.1994) ("New Mexico has recognized a theory of quantum meruit distinct from contract."). We agree that unjust enrichment is much like a contract claim, but we decline to hold that it fits within the arbitration clause's exception because the settlement agreement is not clear on this point and we resolve ambiguity in favor of arbitration. *See McMillan,* 2004-NMSC-002, ¶ 9, 135 N.M. 17, 84 P.3d 65.

SCOPE OF THE ARBITRATION CLAUSE

{21} Because we conclude that Plaintiffs' claims for violation of the Unfair Practices Act, fraud, and unjust enrichment do not fit within the settlement agreement's exception to its arbitration clause, we must determine whether they are claims "regarding (a) the price or value under Non-Qualified Contracts . . . [or] (b) regarding Non-Qualified Other Transportation Charges." As we have

noted, the arbitration provision in this case is narrow because it only applies to claims regarding non-qualified contract prices and transportation charges and "shall, in no event, apply to any future claims for breach of this Agreement." Because the clause is narrow, our usual presumption in favor of arbitration will not resolve the issue. *Cf. Heye,* 2003-NMCA-138, ¶ 8, 134 N.M. 558, 80 P.3d 495 (noting that the presumption in favor of arbitration does not apply when the parties dispute the validity of an agreement to arbitrate). We review the factual allegations underlying these claims, bearing in mind the clearly expressed intent of the parties in agreeing to arbitration. *See Shaeffer,* 95 N.M. at 185, 619 P.2d at 1229.

{22} First, we examine Plaintiffs' claim for violation of the Unfair Practices Act. The complaint alleges several facts relevant to this claim. Plaintiffs allege that Kinder Morgan "made false or misleading statements" and that those statements misled Plaintiffs as to "the value of Unit CO2." Plaintiffs further allege that Kinder Morgan paid them "an amount grossly less than the proper and real value." Kinder Morgan has argued that this claim is about prices under non-qualified contracts. It is true that one way Kinder Morgan could have paid Plaintiffs "less than the proper and real value" is by using the calculation method provided by the settlement agreement, but including improperly valued non-qualified contracts in the average. Plaintiffs do allege, for example, that Kinder Morgan engaged in "pretextual 'bid' arrangements" that reduced the price paid under non-qualified contracts. However, Plaintiffs' allegations are very general. They indicate that the royalties they were paid were too low, but that they have limited information, including "a supposed per well production volume." This reference may indicate

that Plaintiffs intend to prove that Kinder Morgan paid royalties that were too low not because it was using improperly valued non-qualified contracts, but rather, for example, because it deceived Plaintiffs about the amount of carbon dioxide produced. Plaintiffs' complaint simply does not make clear the facts they intend to prove at trial. We note that Plaintiffs' later statements also do not make clear the facts Plaintiffs intend to prove.

[23] Plaintiffs' second claim, for fraud, is likewise framed in general terms. The complaint alleges that Kinder Morgan engaged in a "value reducing scheme" but does not make clear the nature of this "scheme" and does not state the facts Plaintiffs intend to prove at trial. We note, as did Kinder Morgan, that some language in the complaint seems to indicate that Plaintiffs have decided to challenge the prices under non-qualified contracts. But none of this language appears within the section of Plaintiffs' complaint that alleges fraud. And, as noted in the previous paragraph, some language in the general "facts" section of the complaint indicates that Plaintiffs may intend to prove other facts entirely. It is unclear which facts Plaintiffs allege in support of this theory and which facts Plaintiffs allege in support of their claims for breach of the settlement agreement because Plaintiffs have grouped most of their factual allegations together in their complaint.

[24] Finally, we examine Plaintiffs' claim for unjust enrichment. The complaint alleges that Kinder Morgan has been enriched by virtue of "devices and payment methods which have and do deprive plaintiffs and the class members of their proper ... entitlement." Once again, Plaintiffs do not appear to be relying on the prices under non-qualified contracts. Instead, they seem to dispute the method as a whole by which Kinder Morgan

calculated royalty payments. It may be that Plaintiffs can prove at trial that Kinder Morgan's payments were improper notwithstanding that the prices under non-qualified contracts were adequate. However, we agree with Kinder Morgan that Plaintiffs may indeed be challenging the prices under non-qualified contracts. It is simply not clear.

{25} Having concluded that nothing in the complaint clearly states whether the claims for violation of the Unfair Practices Act, fraud, and unjust enrichment are based on a dispute over non-qualified contract or transportation prices, we must now determine whether the district court erred by not sending these claims to arbitration. Applying principles of contract interpretation, we conclude that it would be inappropriate to compel arbitration when we have not been able to determine that Plaintiffs raised any claims covered by the arbitration clause. *See AT & T Techs., Inc.,* 475 U.S. at 648, 106 S.Ct. 1415 ("[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.") (internal quotation marks and citation omitted); *cf. McMillan,* 2004-NMSC-002, ¶ 10, 135 N.M. 17, 84 P.3d 65 (noting that "New Mexico public policy favors freedom to contract" and that, therefore, the limitations in an arbitration clause "must be enforced" unless they violate law or public policy); *Santa Fe Techs., Inc.,* 2002-NMCA-030, ¶ 55, 131 N.M. 772, 42 P.3d 1221 (noting that some arbitration clauses "are drafted with broad strokes and, as a result, require broad interpretation" but that even broad arbitration clauses may be limited in scope). The presumption in favor of arbitration cannot operate to compel arbitration of a particular claim in the absence of an agreement to arbitrate a particular claim.

See Santa Fe Techs., Inc., 2002-NMCA-030, ¶ 52, 131 N.M. 772, 42 P.3d 1221 ("[T]he Court's inquiry is whether the parties have agreed to arbitrate the matter under dispute."); *see also Cummings v. FedEx Ground Package Sys., Inc.*, 404 F.3d 1258, 1262 (10th Cir.2005) ("In construing the scope of a narrow arbitration clause, we must take care to carry out the specific and limited intent of parties."). Given the narrow scope of the arbitration agreement in this case, it is inappropriate to compel arbitration when Plaintiffs may not dispute the prices under non-qualified contracts at all.

CONCLUSION

{26} We emphasize that our decision is based on the lack of clarity in Plaintiffs' complaint and subsequent statements rather than on any perceived ambiguity in the arbitration agreement itself. We attempt to give effect to the intent of the parties as expressed in their agreement, but the structure of the arbitration clause necessitates careful consideration of the manner in which Plaintiffs structured their complaint. *See Cont'l Potash, Inc.*, 115 N.M. at 704, 858 P.2d at 80. Plaintiffs have chosen to group the facts they allege at the beginning of their complaint and it is therefore impossible at this point to determine which facts they intend to prove to establish each claim. Because it is not clear whether Plaintiffs challenge the prices under non-qualified contracts to support their claims for violation of the Unfair Practices Act, fraud, and unjust enrichment, the district court did not err in denying Kinder Morgan's motion to compel arbitration. As the case proceeds, it may become clear that prices of non-qualified contracts or transportation charges are issues with respect to the Unfair Practices Act, fraud,

and/or unjust enrichment claims. If so, Plaintiffs must proceed with such claim or claims in arbitration. The district court is affirmed, with instruction to compel arbitration of Plaintiffs' claims for violation of the Unfair Practices Act, fraud, and unjust enrichment, rather than to allow any of these claims to go to trial, if the claims ultimately concern the prices of non-qualified contracts or transportation charges.

{27} **IT IS SO ORDERED.**

WE CONCUR: *A. JOSEPH ALARID* and *JONATHAN B. SUTIN*, Judges.

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs,

vs. **No. 04-26-CV**

KINDER-MORGAN CO2 COMPANY, L.P.

Defendant.

ORDER DENYING DEFENDANT'S MOTION TO COMPEL ARBITRATION AND FOR STAY PENDING ARBITRATION

(Filed Mar. 11, 2005)

THIS MATTER came before the Court on February 24, 2005 for hearing on Defendant Kinder-Morgan's Motion to Compel Arbitration and for Stay Pending Arbitration. The Court has considered the pleadings filed by the parties, has heard argument of counsel and has considered the evidence submitted on the Motion. The Court FINDS that the Motion is not well-taken and should be DENIED.

IT IS THEREFORE ORDERED that Kinder-Morgan's Motion to Compel Arbitration and for Stay Pending Arbitration is hereby DENIED.

/s/ Eugenio S. Mathis 3/8/05
Honorable Eugenio S. Mathis
District Court Judge

Submitted by:

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IN THE SUPREME COURT OF
THE STATE OF NEW MEXICO

October 11, 2006

NO. 29,990

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs-Respondents,

v.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant-Petitioner.

ORDER

WHEREAS, this matter came on for consideration by the Court upon petition for writ of certiorari filed pursuant to Rule 12-502 NMRA and response thereto, and the Court having considered said pleadings and being sufficiently advised, Chief Justice Richard C. Bosson, Justice Pamela B. Minzner, Justice Patricio M. Serna, Justice Petra Jimenez Maes, and Justice Edward L. Chavez concurring;

NOW, THEREFORE, IT IS ORDERED that the petition hereby is GRANTED and a writ of certiorari shall issue to the New Mexico Court of Appeals; and

IT IS FURTHER ORDERED that a subsequent order shall be entered identifying the issue(s) upon which the petition is granted and setting forth instructions regarding a briefing schedule, if any.

IT IS SO ORDERED.

WITNESS, Honorable Richard C. Bosson, Chief Justice of the Supreme Court of the State of New Mexico, and the seal of said Court this 11th day of October, 2006.

(SEAL) /s/ Kathleen Jo Gibson
Kathleen Jo Gibson, Chief Clerk
of the Supreme Court of the
State of New Mexico

IN THE SUPREME COURT OF
THE STATE OF NEW MEXICO

May 10, 2007

NO. 29,990

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs-Respondents,

v.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant-Petitioner.

ORDER

WHEREAS, this matter came on for consideration upon petition for writ of certiorari and response thereto filed pursuant to Rule 12-502 NMRA, and the Court having considered said pleadings and being sufficiently advised, issued its writ of certiorari on October 11, 2006; and

WHEREAS, having considered the petition, briefs, and oral argument by the parties, the judgment of the Court is that the writ shall be quashed as improvidently granted, Chief Justice Edward L. Chavez, Justice Pamela B. Minzner, Justice Patricio M. Serna, Justice Petra Jimenez Maes, and Justice Richard C. Bosson concurring;

NOW, THEREFORE, IT IS ORDERED that the writ of certiorari issued on October 11, 2006, hereby is QUASHED; and

IT IS FURTHER ORDERED that the record proper, supplemental record proper, and taped proceedings shall be returned to the New Mexico Court of Appeals.

IT IS SO ORDERED.

WITNESS, Honorable Edward L. Chavez, Chief Justice of the Supreme Court of the State of New Mexico, and the seal of said Court this 10th day of May, 2007.

(SEAL) /s/ Kathleen Jo Gibson
Kathleen Jo Gibson, Chief Clerk
of the Supreme Court of the
State of New Mexico

IN THE SUPREME COURT OF
THE STATE OF NEW MEXICO

MANDATE NO. 29,990

TO the New Mexico Court of Appeals, GREETINGS:

WHEREAS, in cause numbered 25,735 on your civil docket, wherein J. Casper Hiemann, et al., were plaintiffs, Kinder-Morgan CO2 Company, L.P., was defendant, an opinion was issued by the New Mexico Court of Appeals on August 8, 2006;

WHEREAS, the cause was afterwards brought by the State into this Court for review by petition for writ of certiorari, and a writ of certiorari was issued on October 11, 2006; and

WHEREAS, an order quashing the writ of certiorari was entered on May 10, 2007.

NOW, THEREFORE, this cause is remanded to you for further proceedings, if any.

WITNESS, Honorable Edward L. Chavez, Chief Justice of the Supreme Court of the State of New Mexico, and the seal of said Court this 10th day of May, 2007.

(SEAL) /s/ Kathleen Jo Gibson
Kathleen Jo Gibson, Chief Clerk
of the Supreme Court of the
State of New Mexico

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs,

vs. **No. 04-26-CV**

KINDER-MORGAN CO2 COMPANY, L.P.

Defendant.

CLASS ACTION COMPLAINT FOR DAMAGES AND INJUNCTION

(Filed Aug. 3, 2004)

Plaintiffs bring this action on behalf of themselves and royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit ("Unit") similarly situated and for their claims against the defendant Kinder-Morgan CO2 Company, L.P. ("Kinder-Morgan") state the following.

I.

PARTIES AND JURISDICTION

1. Plaintiff J. Casper Heimann is a resident of Union County. He is the owner of royalty interests in leases held by Kinder-Morgan in the Unit and was a representative plaintiff in the class action case styled *Doris Feerer, et al. v. Amoco Production Company, et al.*, U.S.D.C.N.M., Civ. No. 95-0012 JC/WWD ("Feerer Class Action"). Plaintiff

Pecos Slope Royalty Trust owns overriding royalty burdening leases in the Unit held by Kinder-Morgan; Robert P. Creson, Jr. and Cynthia C. Clendenen are trustees of the trust. Plaintiff Rio Petro Ltd., is a Texas limited partnership that owns overriding royalty burdening working interests in leases in the Unit held by Kinder-Morgan; Robert P. Creson, Jr. is the general partner.

2. Defendant Kinder-Morgan is a Texas limited partnership authorized to do business in New Mexico. Its resident agent for service of process is Corporation Service Company, Suite 223, 125 Lincoln Ave., Santa Fe, New Mexico 87501. Kinder-Morgan is the successor-in-interest and assignee from Shell Western E&P Inc. and Shell CO2 Company, Ltd. ("Shell") of extensive leasehold interests in the Unit and also to the obligations and responsibilities set forth in the Class Action Settlement Agreement in the Feerer Class Action. Kinder-Morgan is a major producer and transporter of carbon dioxide (CO2) and a major user of CO2 for tertiary oil recovery in the Permian Basin of Texas.

II.

VENUE

3. Venue is proper in this district pursuant to NMSA 1978 § 38-3-1A. and F. Plaintiff Heimann is a resident of Union County, New Mexico and defendant Kinder-Morgan is a foreign corporation admitted to do business in New Mexico.

III.

CLASS ACTION STATUS

4. This action arises from the failure of the defendant to pay the full royalty and overriding royalty ("Royalty Interests") on the true and proper settlement value of compressed CO2 produced from the Unit. Pursuant to Rule 1-023 NMRA 2004, the plaintiffs bring this action as a class action on their own behalf and on behalf of all current owners and former owners, during the period January 2000 to the present, who have Royalty interests burdening the oil and gas leases in the Unit held by the defendant. The class members are the private property Royalty Interest owners whose interests derive from fee lands, thus excluding the Commissioner of Public Lands and the United States of America. The class also excludes those private Royalty Interests that are not unitized as part of the Unit, the so-called unratified royalty owners.

5. The plaintiffs were members of a class certified as a class action by the Untied [sic] States District Court for the District of New Mexico in the Feerer Class Action.

6. On June 25, 1996, the United States District Court in the Feerer Class Action held that the class here proposed meets the requirements of Federal Rule of Civil Procedure 23 and should be certified under that class action procedure which applies the same standard for class actions as Rule 1-023 NMRA 2004. This action is functionally a continuation of the assertion of class-wide rights and claims for underpaid royalty and attendant causes of action that have arisen since the settlement of the Feerer Class Action on behalf of the same Royalty Interests owners class.

7. Each of the named plaintiffs own Royalty Interests in the Unit, and has done so and continues to do so for the period January 1, 2000 to the present. Each of the named plaintiffs has been and is paid on those Royalty Interests monthly by Kinder-Morgan, and Kinder-Morgan's method of calculation of such payment and the monthly remittance statement presentations by it are the same for all plaintiffs and all class members.

8. The oil and gas leases and other instruments creating the Royalty Interests were modified as to the basis for the payment of such interests by the terms of the Unit Agreement for the Development and Operation of the Unit (a copy of which is possessed by defendant). In turn the Class Action Settlement Agreement ("Settlement Agreement") entered on April 1, 1998 in the Feerer Class Action modified the Unit Agreement and established terms effective with Unit production on and after January 1, 1998 for the payment of royalty from the defendant to the plaintiffs and class members. A true copy of the Settlement Agreement is attached and incorporated as Exhibit "A".

9. The basis for the royalty settlement values to be used in paying the subject Royalty Interests is the same for all class members and, in summary terms, provides that sales or delivery of CO2 at the wellhead and reduction of values by netting out expenses of gathering, dehydration and compression are prohibited; that the "1994 Contract" (as defend [sic] in the Settlement Agreement) prices cannot be utilized; that value shall be formulated at the Unit Tailgate (as defined in the Settlement Agreement); that deductions for pipeline transportation on sales or delivery downstream from the Unit Tailgate are subject to specified cents per Mcf caps. Within the aforestated

terms, the Settlement Agreement provides the royalty values are to be "proper" and not "improper."

10. Each plaintiff and member of the class has been similarly underpaid Royalty Interests by Kinder-Morgan on CO2. The defendant has engaged in across the board methods of fabricating prices and fixing self serving false values for the Unit CO2 which practices financially impact each and every class members detrimentally in the same manner. Kinder-Morgan has failed to disclose these matters to plaintiffs and to the members of the class who previously had no knowledge of the underpayments and no information on which to assess the true and proper value of the CO2.

11. There is a well-defined commonality of interest in the questions of law and fact involved that affect the parties to be represented. Common questions of law and fact predominate over questions that may affect individual class members.

12. Plaintiffs are committed to prosecuting this action and have retained experienced and competent counsel with expertise in oil and gas industry litigation and the direct experience of prosecuting an action for damages for wrongful payment of State of New Mexico CO2 royalties on production from the Unit. The claims of plaintiffs are typical of the claims of the class, and plaintiffs have the same interests as other members of the class. Plaintiffs are adequate representatives of the class and will fairly and adequately protect the interests of all like situated Royalty Interest owners.

13. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Prosecution of separate actions by individual

members of the class would create a risk of inconsistent adjudication which would establish incompatible standards of conduct for the defendant, and adjudication with respect to individual members of the class would as a practical matter be dispositive of the interests of the other members not parties to the adjudication.

14. This action should be certified pursuant to Rule 1-23 NMRA 2004 as a class action that constitutes a continuation and updating of the class certified in the Feerer Class Action. The defendant as assignee of Shell and a party in privity therewith is estopped to oppose or deny the certification of the class and the suitability of plaintiffs as class representatives.

IV.

FACTS COMMON TO ALL CLAIMS

A. Background

15. CO2 is commonly volumetrically measured in an "Mcf," which is 1,000 cubic feet at a stated pressure basis, in this case at 14.73 psi or 15.025 psi. The word "gathering" as used here refers to the collecting of gas from each producing well and moving it by pipes to a central plant at Rosebud, New Mexico for compression and dehydration. A "pipeline is a high pressure transmission system which delivers the compressed and marketable CO2 from the Unit Tailgate to a terminus at Denver City, Texas, from where it may be transported in lateral" pipelines for tertiary recovery of oil. The word "price" when appearing in quotes herein is meant to indicate that defendant has attributed an amount of cents to an Mcf of CO2 at the Unit for its unilateral calculation of royalty, as contrasted with the common use of that word meaning an amount arrived

at in an arm's length transaction by economically opposed parties in a functioning market.

16. For more than twenty years major oil companies have used CO2 in their enhanced oil recovery ("EOR") operations in mature oil fields to recover oil not producible by primary or secondary means. In this regard, CO2 is injected into oil bearing reservoirs and enhances oil production by mixing with and displacing crude oil from the pore spaces in the oil bearing formations.

17. The Unit covers over 910,000 acres in Harding, Union and Quay Counties, New Mexico. It is the largest carbon dioxide gas unit in the United States and contains one of the largest known recoverable reserves of pure CO2 in the world. About 2.5 trillion cubic feet of gas has been produced from the Unit and it presently produces about 330-350 million cubic feet per day (MMCFD). Since April of 1984, the produced CO2 has been made marketable by gathering, dehydrating and compressing it into a super-critical state (at 1800-2000 psi) so that it is suitable to be transmitted by pipelines to the EOR fields in West Texas and Southeast New Mexico and there injected into the reservoirs for enhanced recovery of crude oil. In the case of mature oil fields that no longer produce on a primary basis and have undergone secondary recovery by waterflooding, the compressed CO2 is a crucial commodity that allows tertiary recovery of an additional 10-20% of the oil in such fields.

18. The proper economic value (as opposed to artificial "prices") of the Unit CO2 is directly related to the value of the oil that is recovered and sold by virtue of the CO2 injection.

19. Kinder-Morgan Energy Partners, the parent company, formed the defendant subsidiary in 2000 following its purchase of Shell CO2 Company, Ltd. The defendant is the assignee and successor in interest of Shell Western E & P Inc. and Shell CO2 Company Ltd. ("Shell") as to the latter companies' working interest and lessee obligations in the Unit and as to those Shell companies status as parties bound by the Settlement Agreement.

20. The Shell purchase by Kinder-Morgan included a 45% working interest in the McElmo Dome Field, a CO2 source field in southwestern Colorado, a 50% ownership in the Cortez pipeline, which transports CO2 to the Denver City pipeline hub and an 11% working interest in the Unit.

21. Shortly after the Shell acquisition Kinder-Morgan, or its parent company, purchased the SACROC Unit in Surrey County, Texas, a large EOR field that has been using CO2 for tertiary recovery for many years. Kinder-Morgan has expended hundred [sic] of millions of dollars in accelerating the CO2 development program for the SACROC Unit including drilling and reworking wells and constructing CO2 recycle and compression facilities. Kinder-Morgan is injecting 250-300 million cubic feet of CO2 each day at that field and has thereby increased daily the oil production of the SACROC Unit from 17,000 barrels to about 26,000 barrels.

22. In or about 2002, Kinder-Morgan increased its ownership in another West Texas EOR project, the Yates Field, to 50% in which CO2 flooding has been initiated and is being expanded.

23. The period January 2000 to the present has seen Kinder-Morgan's demand for and delivery of CO2 from the Unit and from McElmo Dome increase significantly and

correspondingly its production of oil has grown so that Kinder-Morgan is a leading Texas producer of oil based on CO2 flooding. Correspondingly, the period January 2000 to the present has seen historically unprecedented and sustained high oil prices. During that period the price per barrel of West Texas oil has been in the range of $25 to $40 per barrel with the higher end of that range occurring in 2003 and to the filing of this action in August 2004. Likewise, natural gas and natural gas liquids recovered with the EOR oil have sold at sustained high prices during the material period.

24. The consistently strong oil prices that began to be realized in late 1999 have greatly increased the demand for CO2 for enhanced oil recovery projects and the operators of the McElmo Dome and the Unit source fields have reacted by increased drilling of wells in an effort to provide a sufficient supply of CO2 to meet the growing demand.

25. There is no efficient market for the CO2 from the Unit. Over Ninety-five percent (95%) of the monthly Unit production is not bought or sold but rather is delivered-in-kind by Kinder-Morgan and other Unit working interest owners for their own use in EOR fields. Small quantities of the CO2 from the Unit are some times the subject of pretextual "bid" arrangements resulting in a sales contract reciting a "price" per Mcf of CO2 delivered at a Permian Basin oil field. Some Unit working interest owners have cited such "prices" as a basis for valuing CO2 produced at the Unit. From that "price" for CO2 at an oil field is deducted a unilaterally set transportation charge to arrive at the cents per Mcf on which a one-eighth (⅛) royalty or some single digit overriding royalty is calculated and paid.

B. Kinder-Morgan's Royalty Payments 2000-2004.

26. In the 2000-2004 period of historically high oil prices and historically high demand for Unit CO2, Kinder-Morgan has calculated and paid the Royalty Interests at the lowest CO2 prices relative to oil prices in the 20 year history of the Unit. Kinder-Morgan's simulated Unit Tailgate royalty settlement values have ranged between $0.42/Mcf to $0.59/Mcf, increasing by a few cents in the latter months of that period. The actual royalty cost per Mcf to Kinder-Morgan for its in-kind gas at the "prices" it simulates is 5-7 cents per Mcf on ⅛ royalty leases.

27. The oil and gas leases and other instruments creating the Royalty Interests were modified as to the basis for royalty payment by the Unit Agreement and the terms of the Unit Agreement in that regard have been superceded by the Settlement Agreement. Given the direct physical, functional and economic connection between the Unit CO2 and the recovery of and sale of oil and other hydrocarbons from the EOR fields where the CO2 is used, the growing demand for CO2 by EOR operators, and other relevant circumstances, the values set by the defendant for payment of the subject Royalty Interests are patently and significantly improper.

C. Damages and Concealment

28. By virtue of the vertical integration of the tertiary recovery activity of defendant consisting of (a) production of CO2, (b) transportation of the compressed CO2 and (c) injection of the CO2 for oil recovery, the defendant has been uniquely situated to know the true economics of this enterprise, to appreciate the highly crucial and essential role of the injectable CO2 and has

used that position to deliberately manipulate the financial consequence to be attributed to each of the three activities.

29. The defendant has intentionally and systematically acted to financially infringe upon and disregard the rights and interests of the plaintiffs and the class members who are the owners of the CO2 that has in the period in question provided much of the wealth Kinder-Morgan and its shareholders have enjoyed.

30. Kinder-Morgan has concealed the improper basis upon which the royalty calculations are made and the actual economic consequences and benefits enjoyed by it which economic benefits are not and have not been shared by Kinder-Morgan with the Royalty interest owners.

31. The plaintiffs and the class members are not sophisticated, knowledgeable or informed concerning the CO2 "price" formulating schemes of the defendant nor of the economics associated with the business of and tax benefits afforded EOR operations. The plaintiffs and the class members have only the information allowed them by defendant on the monthly remittance statements that set forth a price per Mcf, a supposed per well production volume and monetary amounts deducted for transportation and taxes.

IV.

FIRST CLAIM FOR RELIEF
Violation of Unfair Practices Act

32. Plaintiffs incorporate by reference the allegations of paragraphs 1 through 31.

33. The defendant has made false or misleading statements to the plaintiffs and the class by its monthly royalty remittances which tend to or have deceived and misled the plaintiffs concerning the value of Unit CO2 as it pertains to the payment amount of plaintiffs' Royalty Interests.

34. Defendant has taken advantage of the lack of knowledge of the plaintiffs to a grossly unfair degree and paid the Royalty Interests in an amount grossly less than the proper and real value.

35. The defendant has engaged in unfair and deceptive trade practice and unconscionable trade practices, and it has done so knowingly and willfully in violation of the Unfair Practices Act, NMSA 1978 Section 57-12-1 et seq. (1995) entitling the plaintiffs to an award of compensatory damages in the amount of three times actual damages, and for an award of attorneys' fees and costs.

SECOND CLAIM FOR RELIEF
Constructive Fraud

36. Plaintiff incorporates by reference the allegations of paragraphs 1 through 35.

37. By virtue of the relationship between plaintiffs and class members and on the other hand the defendant as a working interest owner on whom the class members depend for development of the minerals, and owing to the trust and reliance on the honesty of defendant that the plaintiffs and the class must necessarily place in the defendant and other Unit working interest owners, and because of the superior and important knowledge concerning the CO2 economics and uses available only to it,

defendant at all times owed to plaintiffs a duty to fully and fairly disclose to the plaintiffs and to the class members the true and complete material information concerning the proper value of the Unit produced CO2 upon which the Royalty Interest payments should be made.

38. By having made monthly reports to the plaintiffs and class members purportedly providing information as to the basis for payment of the Royalty Interests, the defendant had and has a duty to disclose completely and truthfully all material facts that pertain to the true and proper value of the CO2 and the correct Royalty Interests calculation. The value reducing scheme exerted by defendant is contrary to public policy and to sound and accepted morals.

39. The defendant has breached the described duties to the plaintiffs and those breaches constitute constructive fraud which has proximately caused damages to the plaintiffs. The defendant's breaches were and are intentional, willful, malicious and undertaken with a culpable state of mind so that punitive damages should be awarded to plaintiffs as determined at trial.

THIRD CLAIM FOR RELIEF
Breach of Contract and of the Covenant of Good Faith and Fair Dealing

40. Plaintiffs incorporate by reference the foregoing paragraphs 1 through 35.

41. The Settlement Agreement provides that effective for Unit CO2 production occurring on and after January 1, 1998, the Royalty Interests of the plaintiffs and

class members would be calculated in accordance with that agreement by defendant as successor to Shell.

42. As applicable to calculation and payment of the subject Royalty Interests by defendant for the period beginning January 2000 the point of valuation is the Unit Tailgate, Unit area expense cannot be deducted to reduce or net-back the price and the pipeline charge is capped. The CO2 royalty settlement value to be used by defendant in paying the subject Royalty interests must be "proper."

43. Kinder-Morgan has for the material time uniformally set "prices" that are not formed by true market forces, are grossly less than the value relative to the oil and other hydrocarbons that but for the CO2 would not be recovered and are fixed by the defendant to serve its objectives of (a) reducing expense and (b) maximizing its profit. That conduct has breached and continues to breach the letter and intent of the Settlement Agreement.

44. Every contract in New Mexico imposes the duty of good faith and fair dealing upon the parties in performance and enforcement of the contract, and particularly such duty is imposed upon contracts for the purchase and sale of a commodity. NMSA 1978 § 55-1-203.

45. Kinder-Morgan has breached its contractual obligations and acted in bad faith by fabricating improper and dishonest "prices" for Unit CO2.

46. The foregoing acts and breaches of duties were done intentionally to cause damage and as a part of and in furtherance of a scheme by defendant the object of which is to wrongfully deprive the plaintiffs and the class of their lawful rights and interests, including the right to receive proper royalties for CO2 produced from the Unit.

47. Defendant's breach of the Settlement Agreement and of the implied covenant was done and is continued intentionally, with a wanton disregard of plaintiffs' rights, maliciously and with a culpable state of mind, so that plaintiffs and the class should be awarded punitive damages in such amount as determined at trial.

FOURTH CLAIM FOR RELIEF
Breach of Implied Covenant to Market

48. Plaintiffs incorporate by reference the allegations of paragraphs 1 through 47.

49. As a working interest owner, defendant is subject to an implied covenant to market which extends to plaintiffs and all class members. At all times defendant was and is obligated, among other things, to act with due regard for the rights and interests of the class members and to achieve the best price or value for CO2 produced from the Unit reasonably possible under the circumstances.

50. Defendant either took CO2 in kind from the Unit for its own use or sold it to itself at self-fixed "prices" whose true function was and is to reduce the business costs of royalty, overriding royalty and State of New Mexico severance taxes. In doing so, defendant deliberately breached its implied duties to market the CO2, and deliberately failed to achieve or to derive the best prices reasonably available for the sale or delivery of such CO2 or to pay the Royalty Interests, on the basis of the true and proper relative value in the use of such CO2 for tertiary oil recovery.

51. Defendant's acts in breach of the implied duty to market were done intentionally to cause damage and as a part of and in furtherance of a conspiracy between and among unit working interest owners, the object of which is to wrongfully deprive plaintiffs and class of their lawful rights and interest, including the right to receive just and proper royalties for CO2 produced from the Unit. As a result of its breach of the implied covenant to market, defendant has proximately caused the plaintiffs and class members to suffer actual damages.

52. Defendant's breach of the implied covenant was done and is continued, intentionally, maliciously and with a culpable state of mind, so that plaintiffs and the class should be awarded punitive damages in such amount as determined at trial.

FIFTH CLAIM FOR RELIEF
Accounting, Unjust Enrichment and Injunction

53. Plaintiffs incorporate by reference the allegations of paragraphs 1 through 31.

54. By virtue of its position as lessee, by virtue of covenants implied at law and by virtue of principles of equity, the defendant as mineral lessee exploiting the economic fruits of Unit CO2 has a duty to share those economic benefits with plaintiffs and class members in proportion to those owners' respective fractional divisions of Royalty Interests in the CO2 produced from the Unit leases.

55. The defendant has willfully and in violation of duties imposed by law and equity failed and continues to fail to fairly share the true economic benefit of the CO2

produced from the Unit subject to plaintiffs' Royalty Interests by devices and payment methods which have and do deprive plaintiffs and the class members of their proper Royalty Interests entitlement.

56. It is necessary and fitting that defendants account for, disgorge and pay to plaintiffs and the class members all Royalty Interests amounts it is determined by the Court that defendant has failed to pay in the past as required by law and equity and do so in order that defendant shall no longer be unjustly enriched.

57. Due to the nature of the relationship between defendant and plaintiffs and the class members, that relationship will continue into the future after entry of judgment in this case; defendant will remain obligated to pay future Royalty Interest payments to plaintiffs and members of the class. Plaintiffs are entitled to an Order permanently enjoining defendants from utilizing its current, improper methods of royalty calculation and payment, in whole or in part, to the extent that such methods are determined to be wrongful and mandating true and proper calculation and payment of Royalty Interests in a manner established by the evidence.

58. With respect to the request for injunctive relief as to prospective Royalty Interest payments, plaintiffs lack an adequate remedy at law. Without an award of injunctive relief, plaintiffs will be required to file a multiplicity of suits in order to enforce their rights.

WHEREFORE the plaintiffs pray the orders and judgment of the Court,

A. That at the earliest practicable time the Court certify this case as a class action and the plaintiffs as a class representatives of a class defined as follows:

> All present and former owners of royalty interests or overriding royalty interests in fee lands whose interests have been unitized under the Bravo Dome Carbon Dioxide Unit Agreement and whose interests burden leases held by the defendant Kinder-Morgan and have since January 2000.

B. That upon trial the Court award the plaintiffs and the class compensatory damages, punitive damages, pre-judgment interest, attorney fees and costs.

C. That the Court enter its injunction against the defendant's continued unlawful and wrongful conduct and affirmatively require and specify a method of Royalty Interests calculation that reflects the proper and true value of the Unit CO2 as an agent for the recovery of otherwise unrecoverable oil.

D. That the Court grant such other and further relief as is proper.

Respectfully submitted,

GALLEGOS LAW FIRM, P.C.

By /s/ J E Gallegos
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STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated.

Plaintiffs,

vs. No. D-818-CV-2004-00026

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant

DEFENDANT KINDER MORGAN CO2 COMPANY, L.P.'S MOTION TO COMPEL ARBITRATION AND FOR STAY PENDING ARBITRATION

(Filed Oct. 1, 2004)

COMES NOW, Kinder Morgan CO2 Company, L.P. ("Kinder Morgan"), and submits this Motion to Compel Arbitration and for Stay Pending Arbitration.

I.

INTRODUCTION

Plaintiffs J. Casper Heimann, Pecos Slope Royalty Trust, and Rio Petro Ltd. ("Plaintiffs") assert claims relating to alleged underpayment of royalties on carbon dioxide produced from the Bravo Dome Carbon Dioxide Unit ("the Unit"). As demonstrated herein, all of Plaintiffs' claims are subject to mandatory arbitration pursuant to an arbitration clause contained in a settlement agreement

executed in connection with the settlement of prior royalty litigation involving the Unit. Plaintiffs clearly and unequivocally acknowledged the arbitrability of the claims by filing an arbitration demand seeking arbitration of the claims pursuant to the arbitration clause in the settlement agreement, but Plaintiffs subsequently withdrew that arbitration demand and filed this lawsuit. Both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act require that Plaintiffs be compelled to arbitrate their claims and that this action be stayed pending arbitration.

A. The Parties

Plaintiffs claim to be royalty owners in the Bravo Dome Carbon Dioxide Unit ("the Unit"). Since January 2000, Kinder Morgan has owned working interests in the Unit and has produced and sold carbon dioxide from the Unit and paid royalties thereon. Kinder Morgan acquired its interest in the Unit from Shell Western E&P Inc. and Shell CO2 Company Ltd. (collectively "Shell"). Plaintiffs purport to assert claims against Kinder Morgan on behalf of themselves and on behalf of a class of former and current royalty owners during the period January 2000 to present who own or owned royalty interests burdening the oil and gas leases in the Unit held by Kinder Morgan.

B. The *Feerer* Settlement

Prior to Kinder Morgan's acquisition of an interest in the Unit, a settlement agreement was entered into in connection with a class action lawsuit pending in the United States District Court for the District of New Mexico, styled *Feerer, et. al. v. Amoco Prod. Co., et. al.*, Civ.

No. 95-0012 JC/WWD. In the *Feerer* case, the plaintiffs asserted, among other things, that the owners of working interests in the Unit, including Shell (Kinder Morgan's predecessor-in-interest), had underpaid royalties. Plaintiff J. Casper Heimann, who is one of the named plaintiffs in this case, was a named plaintiff and a class representative in the *Feerer* case and was a signatory party to the settlement agreement. The settlement agreement was entered into on behalf of the named plaintiffs and on behalf of a settlement class of private royalty owners in the Unit. A true and correct copy of the settlement agreement in the *Feerer* case is attached hereto as Exhibit 1 and is referred to herein as "the Settlement Agreement."

C. The Agreed Royalty Methodology Provided in the Settlement Agreement

As part of the settlement, the settlement class of royalty owners and the working interest owners in the Unit agreed to a methodology for the calculation of royalties subsequent to January 1, 1998. Specifically, Section 14 of the Settlement Agreement provides that the working interest owners "will utilize the royalty settlement methodology and the identified benchmarks set forth in subparagraphs (a), (b) and (c) below for the purpose of calculating and paying royalty to their Respective Owners, which methodology, benchmarks and resulting payments are hereby agreed to and approved by Amoco's, Hess's and Shell's Respective Owners." That methodology involves the use of a "net-back" price in calculating royalties.

Specifically, the royalty owners agreed that the working interest owners could use certain specified pre-approved

sales contracts and certain specified pre-approved transportation charges in calculating the net-back price used to pay royalty. With regard to Shell, the pre-approved sales contracts (referred to in the Settlement Agreement as "Qualified Contracts") were identified in Schedule D-3 of the Settlement Agreement, and the pre-approved transportation charges (referred to in the Settlement Agreement as the "Approved Mainline Deduction" and the "Qualified Other Transportation Charges") were identified in Section 11.2(a) and Schedule E-3 of the Settlement Agreement. The Settlement Agreement provided in Section 14(c) that the working interest owners were not precluded from using benchmarks other than the "Qualified" sales contracts and the "Approved" and "Qualified" transportation charges, but there was no pre-approval of such other contracts by the royalty owners. Any contract prices and transportation charges used by the working interest owners in the calculation of royalties that were not approved by the royalty owners in the Settlement Agreement were defined in Sections 14(g) and 14(h) of the Settlement Agreement as "Non-Qualified Contracts" and "Non-Qualified Other Transportation Charges," respectively. In Section 14(j) of the Settlement Agreement, the royalty owners expressly reserved the right to claim in the future that a Non-Qualified Contract or a Non-Qualified Other Transportation Charge used in the calculation of royalties was improper.

As noted above, Plaintiff J. Casper Heimann was a named plaintiff in the *Feerer* case and was a signatory party to the Settlement Agreement. Plaintiffs Pecos Slope Royalty Trust and Rio Petro Ltd. are current royalty payees of Kinder Morgan and allege in this lawsuit that they are entitled to enforce the Settlement Agreement.

D. The Arbitration Clause

Section 16 of the Settlement Agreement contains a mandatory arbitration provision. Specifically, the royalty owners and the working interest owners agreed as follows:

> Any claims asserted by Plaintiffs or members of the Class against Amoco, Hess or Shell regarding (a) the price or value under Non-Qualified Contracts (or under amendments to or extensions of contracts establishing new prices or values under Qualified contracts as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners and, (b) regarding Non-Qualified Other Transportation. Charges (or amendments to or extensions of contracts or other arrangements establishing Qualified Other Transportation Charges as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding arbitration. . . .

E. Kinder Morgan's Royalty Payments Utilizing the Settlement Agreement Methodology

Since Kinder Morgan acquired its interest in the Unit, it has calculated and paid royalty using the net-back methodology provided in the Settlement Agreement. That methodology has involved determination of net-back prices, using both Qualified Contracts and Non-Qualified Contracts, Approved Mainline Deductions, and Non-Qualified Other Transportation Charges, as those terms are defined in the Settlement Agreement. Attached hereto

as Exhibits 2, 3, 4, 5, and 6 are true and correct copies of the royalty price calculation spreadsheets reflecting the manner in which Kinder Morgan calculated the net-back prices used in paying royalties to its private royalty owners for the period January 2000 through July 2004. Attached hereto as Exhibit 7 is a spreadsheet summarizing the sales contracts that Kinder Morgan has utilized in the calculation of the net-back prices used in the payment of royalties at various times over that same period. Attached hereto as Exhibit 8 is a sample of remittance statements for royalty payments made to Plaintiffs that utilize the net-back prices calculated pursuant to the Settlement Agreement.

F. The Plaintiffs' Arbitration Demand and Subsequent Lawsuit

On July 26, 2004, Plaintiffs filed a "Statement of Class Action Claims and Notice of Demand for Arbitration," referred to herein as "Plaintiffs' Arbitration Demand." A true and correct copy of Plaintiffs' Arbitration Demand is attached hereto as Exhibit 9. Pursuant to the arbitration clause in Section 16 of the Settlement Agreement, Plaintiffs submitted these claims to arbitration on their own behalf, and on behalf of a class of current and former royalty owners in the Unit. However, a week later, on August 2, 2004, Plaintiffs filed a "Withdrawal" of Plaintiffs' Arbitration Demand. A true and correct copy of the "Withdrawal" is attached hereto as Exhibit 10. The next day, on August 3, 2004, Plaintiffs filed this lawsuit.

II.

SUMMARY OF ARGUMENT

The Settlement Agreement provides the agreed-upon net-back methodology for calculation and payment of royalties. That agreement establishes a safe harbor for royalty payments to the extent that the net-back calculation is based on Qualified Contracts, Approved Mainline Deductions, and Qualified Other Transportation Charges. Royalty owners are entitled, however, to challenge the net-back calculation (and resulting valuations and payments) to the extent based on Non-Qualified Contracts and Non-Qualified Other Transportation Charges. The law requires that the Court look to the factual allegations of the complaint to determine whether the claims sought to be asserted in this lawsuit fall within the scope of the arbitration clause. All of Plaintiffs' claims are necessarily predicated on a challenge to the portions of Kinder Morgan's net-back price calculations that are subject to challenge under the Settlement Agreement, i.e., the portions of the calculations that utilize "Non-Qualified" contracts and "Non-Qualified" transportation charges. Section 16 of the Settlement Agreement provides that such claims are subject to mandatory arbitration. The agreement to arbitrate is enforceable under both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act, and accordingly, both federal and New Mexico law require that arbitration of the claims be compelled, and that this action be stayed pending arbitration.

III.

ARGUMENT AND AUTHORITIES

A. Both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act Require Enforcement of the Arbitration Clause

Section 2 of the Federal Arbitration Act ("FAA") provides that arbitration agreements "involving commerce" are enforceable in both state and federal courts as a matter of federal substantive law. 9 U.S.C. §2; *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984). The "involving commerce" standard is a broad one, reaching any transaction that is within the scope of Congress' power to regulate under the Commerce Clause of the Constitution. *Citizen's Bank v. Alafabco Inc.*, 539 U.S. 52, 56 (2003) ("We have interpreted the term 'involving commerce' in the FAA as the functional equivalent of the more familiar term 'affecting commerce' – words of art that ordinarily signal the broadest permissible exercise of Congress' Commerce Clause power"). The agreements between the private royalty owners and the working interest owners in the Unit, including the net-back price royalty methodology provided for in the Settlement Agreement, relate to the production, transportation, and sale of carbon dioxide in interstate commerce. Thus, the Federal Arbitration Act applies and requires enforcement of the arbitration clause contained in Section 16 of the Settlement Agreement. Furthermore, the arbitration agreement is enforceable as a matter of New Mexico law, pursuant to the New Mexico

Uniform Arbitration Act, NMSA 1978, §§ 44-7-1 to -22 (repealed 2001).[1]

Under both federal and New Mexico law, a court is required to compel arbitration upon a determination that a dispute falls within the scope of an arbitration clause. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219 (1985) ("a court must compel arbitration of otherwise arbitrable claims, when a motion to compel arbitration is made"); *American Express Fin. Advisors v. Makarewicz,* 122 F.3d 936, 940 (11th Cir. 1997) ("[u]nder the FAA, upon motion of a party, district courts must compel arbitration of all claims subject to arbitration"); *Santa Fe Techs. v. Argus Networks,* 131 N.M. 772, 788, 42 P.3d 1221, 1237 (N.M. App. 2001) ("when parties have agreed to arbitrate, the courts must compel arbitration"). Pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. §3, both federal and state courts are required to stay proceedings with regard to claims that are subject to arbitration. *Shearson/ American Express v. McMahon,* 482 U.S. 220, 226 (1987) ("a court must stay its proceedings if it is satisfied that an issue before it is arbitrable under the agreement," citing 9 U.S.C. §3); *United Nuclear Corp v. General Atomic Co.*, 597 P.2d 290, 308 (N.M. 1979) ("Section 3 of the Federal Arbitration Act provides for a stay of pending court action on application of one of the parties when the trial court is satisfied that the issue involved is referable to arbitration and that the applicant for the stay of court proceedings is not in default in proceeding with such arbitration").

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[1] Effective July 1, 2001, the version of the Uniform Arbitration Act in effect at the time the Settlement Agreement was executed was replaced by a new Uniform Arbitration Act, NMSA 1978, §§ 44-7A-1 to -32 (2001).

B. Plaintiffs' Claims Fall Within the Scope of the Arbitration Clause in Section 16

With regard to the question of whether a particular claim is subject to arbitration, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *DeArmond v. Haliburton Energy Servs.*, 81 P.2d 573, 577 (N.M. App. 2003). As the Third Circuit said in *In re Prudential Ins. Co. of Am. Sales Practice Litigation*, 133 F.3d 225, 231 (3rd Cir. 1998):

> Any inquiry into the scope of an arbitration clause must necessarily begin with the presumption that arbitration applies. In considering the nature of the dispute and the scope of the arbitration clause, this court must operate under a "presumption of arbitrability in the sense that 'an order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.'" Thus, when it cannot be said "with positive assurance" that the parties have clearly and unequivocally excepted a certain dispute from arbitration, the court must compel arbitration. A necessary corollary of this axiomatic rule in favor of arbitration is that doubts in interpreting the precise scope of the arbitration agreement are to be resolved in favor of arbitration. While this approach is not a mandate for courts to ignore explicit textual agreements or to reshape the parties' obvious intent, it nevertheless weighs genuine ambiguities against the resisting party.

(citations omitted). Furthermore, in answering the question of whether claims asserted in a case fall within the

scope of an arbitration agreement, the court is to "focus on the factual allegations in the complaint rather than the legal causes of action asserted." *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d 861, 871 (10th Cir. 1999).

Applying these principles, all of Plaintiffs' claims are subject to arbitration. The royalty owners subject to the Settlement Agreement agreed in Section 16 to arbitrate claims "regarding ... the price or value under Non-Qualified Contracts" and claims "regarding Non-Qualified Other Transportation Charges" that were utilized by the working interest owners "in establishing royalty settlement values for purposes of payment to their Respective Owners." As shown below, each of Plaintiffs' causes of action constitutes an attack on the use of "Non-Qualified" contracts and "Non-Qualified" transportation charges utilized in the calculation of net-back prices on which Kinder-Morgan based its royalty payments.

All of Plaintiffs' claims are predicated on the allegation that Kinder Morgan's royalty payments on Unit carbon dioxide since January 1, 2000 are based on net-back valuations that yield values that are too low. The Settlement Agreement provides for a net-back price methodology that utilizes a combination of "Qualified" and "Non-Qualified" contract prices and "Qualified," "Approved," and "Non-Qualified" transportation charges, with the portic of the calculations that are based on "Qualified" contracts and on "Qualified" and "Approved" transportation charges being pre-approved by the royalty owners. As shown by Exhibits 2 through 8 and the Affidavits of Dr. Stephen Becker and James Wuerth attached hereto as Exhibits 11 and 12, Kinder Morgan has paid its royalty based on net-back prices calculated using a combination of "Qualified" and "Non-Qualified" contract prices

and a combination of "Qualified," "Approved," and "Non-Qualified" transportation charges. Because the "Qualified" and "Approved" components of the calculations are not subject to challenge under the Settlement Agreement, Plaintiffs' claims that royalty was paid on a value that was too low are necessarily predicated on the allegation that the "Non-Qualified" components in the royalty calculations yield values that are too low. Accordingly, all of Plaintiffs' claims are subject to arbitration under Section 16 of the Settlement Agreement.

A review of the specific allegations of the Complaint confirms that Plaintiffs' claims fall within the scope of the arbitration clause. In paragraph 4 of the Complaint, Plaintiffs allege that "[t]his action arises from the failure of the defendant to pay the full royalty and overriding royalty . . . on the true and proper settlement value of compressed CO2 produced from the Unit." That this attack is predicated on the alleged wrongful use of prices from "Non-Qualified" contracts and of "Non-Qualified" transportation charges is confirmed by the following allegations:

- "[Kinder Morgan] has engaged in across the board methods of fabricating prices and fixing self serving false values for the Unit CO2." Complaint at ¶10.
- "The word 'price' when appearing in quotes herein is meant to indicate that defendant has attributed an amount of cents to an Mcf of CO2 at the Unit for its unilateral calculation of royalty." Complaint at ¶15.
- "The proper economic value (as opposed to artificial 'prices') of the Unit CO2 is directly related to the value of the oil that is recovered and sold by virtue of the CO2 injection." Complaint at ¶18.

- "Small quantifies of the CO2 from the Unit are some times the subject of pretextual "bid" arrangements resulting in a sales contract reciting a 'price' per Mcf of CO2 delivered at a Permian Basin oil field. Some Unit working interest owners have cited such 'prices' as a basis for valuing CO2 produced at the Unit. From that 'price' for CO2 at an oil field is deducted a unilaterally set transportation charge to arrive at the cents per Mcf on which a one-eighth royalty or some single digit overriding royalty is calculated and paid." Complaint at ¶25.

- "The oil and gas leases and other instruments creating the Royalty Interests were modified as to the basis for royalty payment by the Unit Agreement and the terms of the Unit Agreement in that regard have been superceded by the Settlement Agreement. Given the direct physical, functional and economic connection between the Unit CO2 and the recovery of and sale of oil and other hydrocarbons from the EOR fields where the CO2 is used, the growing demand for CO2 by EOR operators, and other relevant circumstances, the values set by the defendant for payment of the subject Royalty Interests are patently and significantly improper." Complaint at ¶27.

These allegations, which are applicable to all causes of action, demonstrate that Plaintiffs are challenging the "prices" used by Kinder Morgan in calculating CO2 values for royalty payment purposes, which Plaintiffs characterize as "fabricat[ed]," "pretextual," and "artificial," as well as transportation charges that Kinder Morgan has used in calculating CO2 values for royalty payment purposes, which Plaintiffs characterize as "unilaterally set." Because the "Qualified" contract prices and "Qualified" and "Approved"

transportation charges utilized in Kinder Morgan's calculation of the net-back prices used in its royalty payments are not subject to challenge under the Settlement Agreement, the challenged prices and transportation charges are of necessity "Non-Qualified" prices and charges. Plaintiffs' challenges fall directly within the scope of the arbitration clause.

It is "the factual allegations in the complaint rather than the legal. causes of action asserted" that are significant in determining whether claims fall within the scope of an arbitration clause. *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d at 871. The allegations described above, which are incorporated by reference in each of the causes of action asserted in the Complaint, demonstrate that all of Plaintiffs' claims fall within the scope of the arbitration clause. Although there is no need for detailed analysis of the legal causes of action that Plaintiffs assert in this case, such an analysis confirms that all causes of action asserted by the Plaintiffs are arbitrable.

1. Violation of Unfair Practices Act

Plaintiffs assert a violation of the New Mexico Unfair Practices Act, NMSA 1978 Section 57-12-1 et. seq. (1985). That claim incorporates by reference all of the allegations described above, and is based on the alleged payment of the royalty interests "in an amount grossly less than the proper and real value," and on alleged false and misleading statements "concerning the value of Unit CO2 as it pertains to the payment amount of plaintiffs' Royalty Interests." Complaint at ¶¶32-35. The basis for this claim is Plaintiffs' allegation that Kinder Morgan paid royalty on a calculated CO2 value that allegedly is too low. As demonstrated above,

the underpayment allegation necessarily is based on binder Morgan's use of "Non-Qualified" prices and charges that Plaintiffs challenge. Thus, the claim falls within the scope of Section 16 of the Settlement Agreement and is arbitrable, To the extent the Unfair Practices Act provides a judicial forum for claims under that statute, the Federal Arbitration Act preempts any such provision and mandates an order compelling arbitration and staying the proceedings. *See Southland Corp. v. Keating,* 465 U.S. at 10-16 (provision of California franchise statute providing judicial forum for claims was preempted by the FAA); *Commerce Park at DFW Freeport v. Mardian Construction Co.,* 729 F.2d 334, 339-40 (5th Cir. 1984) (provision of Texas Deceptive Trade Practices Act precluding waiver of judicial forum was preempted by the FAA).

2. Constructive Fraud

This claim incorporates the allegations referenced above and is based on Kinder Morgan's alleged "value reducing scheme" and on Kinder Morgan's alleged failure to disclose facts pertaining to "the true and proper value of the CO2 and the correct Royalty Interests calculation." Complaint at ¶38. As shown above, Plaintiffs' challenge to Kinder Morgan's royalty valuation of the CO2 is necessarily based on Kinder Morgan's use of "Non-Qualified" prices and charges. This claim also falls within the scope of Section 16 of the Settlement Agreement and is arbitrable.

3. Breach of Contract and of the Covenant of Good Faith and Fair Dealing

In this claim Plaintiffs incorporate by reference the allegations of paragraphs 1-35 of the Complaint, and they

allege that Kinder Morgan has breached its contractual obligations as follows:

> Kinder Morgan has for the material time uniformly set "prices" that are not formed by true market forces, are grossly less than the value relative to the oil and other hydrocarbons that but for the CO2 would not be recovered and are fixed by the defendant to serve its objectives of (a) reducing expense and (b) maximizing its profit. That conduct has breached and continues to breach the letter and intent of the Settlement Agreement.

Complaint at ¶43. Plaintiffs also allege that "Kinder Morgan has breached its contractual obligations and acted in bad faith by fabricating improper and dishonest 'prices' for Unit CO2." Complaint at ¶45. Again, the "prices" that Plaintiffs challenge in this claim are necessarily the "Non-Qualified" prices that Kinder Morgan uses in its royalty calculations. Thus, the claim is squarely within the scope of Section 16 of the Settlement Agreement.

4. Breach of Implied Covenant to Market

This claim incorporates all prior allegations and asserts that Kinder Morgan breached an implied covenant to market by virtue of the following alleged conduct:

> [Kinder Morgan] either took CO2 in kind from the Unit for its own use or sold it to itself at self-fixed "prices" whose true function was and is to reduce the business costs of royalty, overriding royalty and State of New Mexico severance taxes. In doing so, [Kinder Morgan] deliberately breached its implied duties to market the CO2, and deliberately failed to achieve or to derive the

> best prices reasonably available for the sale or delivery of such CO2 or to pay the Royalty Interest, on the basis of the true and proper relative value in the use of such CO2 for tertiary oil recovery.

Complaint at ¶50. This claim expressly challenges the "prices" that Kinder Morgan used in the calculation and payment of royalties to the royalty owners. Because the prices in "Qualified" contracts are not subject to challenge under the Settlement Agreement, this claim necessarily constitutes a challenge to "Non-Qualified" prices and is arbitrable under Section 16 of the Settlement Agreement.

5. Accounting, Unjust Enrichment and Injunction

This claim incorporates paragraphs 1-31 of the Complaint and asserts that Kinder Morgan should be required to account for and disgorge amounts that it has failed to pay as proper royalties by virtue of its "devices and payment methods which have and do deprive plaintiffs and the class members of their proper Royalty Interests entitlement." Complaint at ¶55. Again, this attack on Kinder Morgan's "payment methods" necessarily represents a challenge to the use of "Non-Qualified" prices and charges in the net-back calculation methodology provided for in the Settlement Agreement. Plaintiffs also seek an order "permanently enjoining [Kinder Morgan] from utilizing its current, improper methods of royalty calculation and payment, in whole or in part, to the extent that such methods are determined to be wrongful. . . ." This request for injunctive relief directly attacks the portions. of Kinder Morgan's net-back price calculation methodology that was not pre-approved in the Settlement Agreement, i.e., the portions of the calculations utilizing "Non-Qualified"

prices and charges. The request for injunctive relief is arbitrable.

C. Plaintiffs' Class Action Allegations Do Not Affect Kinder Morgan's Right to an Order Compelling Arbitration and Staying the Litigation

Plaintiffs purport to assert their claims both on their own behalf and on behalf of a class of royalty owners in the Unit. However, Plaintiffs – who have agreed to arbitrate – cannot avoid their obligation to arbitrate by filing a class action lawsuit. *In re Managed Care Litigation,* 132 F.Supp.2d 989, 999-1000 (S.D. Fla. 2000), *aff'd,* 285 F.3d 971 (11th Cir. 2002). As the Seventh Circuit said in *Caudle v. American Arbitration Association,* 230 F.3d 920, 921 (7th Cir. 2000), "A procedural device aggregating multiple persons' claims in litigation does not entitle anyone to be in litigation; a contract promising to arbitrate the dispute removes the person from those eligible to represent a class of litigants" in a class action court action. *See also Johnson v. West Suburban Bank,* 225 F.3d 366, 368 (3rd Cir.2000) (holding that the district court erred in denying the defendant's motion to compel arbitration and for stay pending arbitration of plaintiffs' claims, despite the existence of class action allegations). Because Plaintiffs are bound to arbitrate their claims under Section 16 of the Settlement Agreement, this Court should compel arbitration and stay this case pending arbitration. The question of whether arbitration is appropriate with regard to the claims made on behalf of the persons Plaintiffs seek to represent as a "class" is a question that must be determined by the arbitrators. *Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444, 450-453 (2003); *Pedcor Management*

Co., Inc. Welfare Benefit Plan v. Nations Personnel of Texas, Inc., 343 F.3d 355, 358-361 (5th Cir. 2003).

IV.

CONCLUSION AND PRAYER

For the reasons discussed above, all of the Plaintiffs' claims fall within the scope of the arbitration clause contained in Section 16 of the. Settlement Agreement. In filing Plaintiffs' Arbitration Demand, Plaintiffs expressly invoked Section 16 of the Settlement Agreement and submitted the claims to arbitration, clearly and unequivocally acknowledging the arbitrability of the claims that they now seek to pursue in court. Plaintiffs' action in withdrawing the Arbitration Demand and filing this lawsuit is contrary to the requirements of Section 16. Even if there were doubts about the arbitrability of the claims, those doubts would be properly resolved in favor of arbitration. *Moses H. Cone,* 460 U.S. at 24-25; *DeArmond,* 81 P.2d at 577; *In re Prudential Ins. Co. of Am. Sales Practice Litigation,* 133 F.3d at 231. The FAA and the New Mexico Uniform Arbitration Act mandate that Plaintiffs be compelled to arbitrate, and that this case be stayed pending arbitration. The determination of whether arbitration is appropriate with regard to the claims asserted on behalf of the "class" that Plaintiffs seek to represent must be resolved by the arbitrators.

Accordingly, Kinder Morgan respectfully prays that the Court enter an order compelling Plaintiffs. to arbitrate their claims, staying the proceedings in this ease pending arbitration, and directing that the question of whether arbitration is appropriate with regard to the claims asserted on behalf of the proposed class members is to be

determined by the arbitrators. Kinder Morgan also seeks such other and further relief to which it is justly entitled.

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CERTIFICATE OF SERVICE

I hereby certify that on this 28 day of September, 2004, a true and correct copy of the foregoing Motion to Compel Arbitration and for Stay Pending Arbitration was mailed first class, postage prepaid, to the following counsel of record:

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/s/ John B. Pound
JOHN B. POUND

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs. **No. 04-26 CV**

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant,

MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION TO COMPEL NO. 1 – DOCUMENTS RELATED TO THE FORMATION OF SALES CONTRACTS, THE VALUE AND PRICES OF UNIT CO_2

I. INTRODUCTION

This case involves the business of using carbon dioxide ("CO_2") by oil companies for enhanced recovery of oil and gas in Permian Basin fields in West Texas and Southeast New Mexico. Plaintiffs and the class own royalties and overriding royalties on the CO_2 produced in the Bravo Dome Carbon Dioxide Gas Unit in Northeastern New Mexico (the "Unit"). Defendant ("Kinder-Morgan") holds oil and gas lessee working interests in the Unit requiring the payment of royalty on CO_2 that is compressed, delivered by pipeline and injected in certain Permian Basin oil fields.

Plaintiffs have sued Kinder-Morgan in this action for underpayment of CO_2 royalties in violation of the

settlement agreement reached between members of the plaintiff class and the various defendants in litigation styled *Doris Feerer, et al. v. Amoco Production Company, et al.*, U.S.D.C. No. 95-0012, referred to herein as the Feerer Settlement Agreement. Kinder-Morgan is a party to that Agreement (f/k/a Shell CO2 Company Ltd.).

Kinder-Morgan and a few other oil companies dominate the production, transportation and use of CO_2 from the Unit and from the McElmo Dome Unit and Sheep Mountain Units, the other natural sources of CO_2 for Permian Basin enhanced oil recovery. Defendant produces CO_2 from the Unit and from McElmo Dome as do Oxy USA and Exxonmobil. They transport it through pipelines which they own to enhanced oil recovery ("EOR") projects in West Texas and Lea County, New Mexico. Kinder-Morgan owns and operates major interests in EOR projects where the compressed CO_2 is injected by it into oil reservoirs in order to achieve otherwise unrecoverable oil production. The sole reason for existence of these source fields, such as the Bravo Dome, is production of CO_2 for enhanced oil recovery. The true value of and demand for the CO_2 is directly related to the amount and price of oil that it can incrementally cause to be recovered and sold. Kinder-Morgan derives handsome economic benefits from its pipeline transportation charges and from the use of the CO_2 through increased production and sales of oil from its EOR projects. That is even more dramatically the case because of the historically high oil prices prevailing during 2000 to the present.

There are three basic links in the value chain of the CO_2: (a) production in the Unit; (b) pipeline transportation from the Unit to the Permian Basin oil fields; (c) enhanced oil and gas production and sale. It is only the revenue

attributed to the first link, CO_2 production in the Unit, which has to be shared with the plaintiffs in the form of royalty and overriding royalty (and with the State of New Mexico for severance taxes). It takes no Ph.D. in economics to understand the financial consequence to the defendant of minimizing the revenue attributable to production at the Unit and allocating revenues and profits to the other two links in the value chain.

In this case, plaintiffs' Class Action Complaint alleges that defendant has underpaid royalties owed to the members of the class by various schemes for depressing the CO_2 prices thereby minimizing expense and increasing defendant's profits in its EOR projects. Plaintiffs believe one scheme involves the creation of sham purchase and sale contracts for CO_2 between Kinder-Morgan and other companies who own and produce CO_2, all of whom use CO_2 in their EOR projects.

Kinder-Morgan represents in various public documents that it utilizes large volumes of the CO_2 from McElmo Dome and the Bravo Dome Unit in its owned EOR projects, primarily SACROC and the Yates Field in West Texas. See documents attached hereto as Exhibit A. Nevertheless, and despite the fact that Kinder-Morgan requires its own CO_2 produced from the Bravo Dome Unit for its own EOR projects, it enters into "contracts" with CO_2 producers and EOR users Oxy USA, Inc., ExxonMobil Corporation, and Amerada Hess Corporation, whereby it purports to "sell" the CO_2 it produces from the Bravo Dome Unit to these other companies.

If the companies simply took and used their share of the CO_2 in-kind there would be no contracts setting prices. In that case the pricing of the in-kind volumes would be

patently suspect. So plaintiffs believe the scheme is one of "you sell to me and I to you and we will fix desired prices for royalty and taxes." It is unclear how much gas actually flows between seller and buyer under these contracts.

Defendant's rigging of artificially low "prices" – below the actual, fair market value of the Unit CO_2 – is a breach of its express and implied obligations under the Feerer Settlement Agreement. That is not an arbitable [sic] issue.

Pursuant to these claims, plaintiffs have requested that the defendant produce documents in four general categories at issue here: (1) documents related to the defendant's EOR projects, including the volumes of Unit CO_2 injected, recovered and re-injected, income generated by Unit CO_2 injection and recycling operations, and increased oil production, income and profits from the EOR projects as a result of the CO_2 operations; (2) documents related to the circumstances surrounding the contracts which form the basis of the computation and payment of royalties to those Unit royalty owners who are members of the class; (3) documents related to pricing of CO_2 relevant to a determination of the proper royalty payment; and (4) documents reflecting Kinder-Morgan's share of CO_2 volumes from the Unit and other CO_2 units in which it owns an interest.

Several categories of documents relate to the economics attendant to the use of CO_2 and are therefore directly relevant to the core of plaintiff's claims. The requested documents should also show how Kinder-Morgan has formed contracts for the sale of Unit CO_2, whether the contracts are arms-length, whether the contracts are actually an exchange of CO_2 mechanism, whether Kinder-Morgan has artificially depressed the price of CO_2 in order

to minimize its royalty payment obligations, and whether Kinder-Morgan has conspired with other CO_2 royalty obligors to administer the prices of Unit CO_2. The evidence will also assist the plaintiffs and eventually the trier of fact in calculating a proper value for the CO_2.

On September 10, 2004, plaintiffs served Kinder-Morgan, with Plaintiffs' First Requests for Production of Documents. A copy is attached as Exhibit B. Plaintiffs requested the production of twenty-one categories of documents. Kinder-Morgan filed on October 4, 2004, a motion to stay discovery until the Court rules on Kinder-Morgan's Motion to Compel Arbitration. Attached to that Motion are monthly summary spreadsheets which reflect some the data and the math used by Kinder-Morgan to derive royalty payments.

Kinder-Morgan has agreed to produce documents that it unilaterally decides have a bearing on the Motion to Compel Arbitration. Pursuant to Kinder-Morgan's agreement to produce a limited number of documents, plaintiffs proposed a compromise on November 1, 2004 regarding the outstanding document requests. See letter attached as Exhibit C. Specifically, plaintiffs proposed that, if Kinder-Morgan produced documents responsive to document requests 10, 11(d), and 12-16, plaintiffs would not seek to compel production of the other requests until after the Court resolves Kinder-Morgan's motion to arbitrate.

On November 11, 2004, Kinder-Morgan responded, refusing to produce any documents relating to document requests 10, 11(d), and 12-16 and claiming, among other things, – that "we believe such requests are overbroad and seek information that has no bearing on the royalty issue." See letter attached as Exhibit D. Rather than respond to

the production requests specifically, Kinder-Morgan announced that it would turn over narrow categories of documents relating to (1) contracts Kinder-Morgan used to determine prices/values for royalty payments (which plaintiff already had received), (2) spreadsheets containing royalty calculations (which duplicate the documents attached as exhibits to the Motion to Compel Arbitration) and (3) certain underlying documents used to determine net-back volumes referenced in the royalty calculation spreadsheets. In so doing, Kinder-Morgan agreed only to produce documents that have, as Kinder-Morgan wrote, a "bearing on the royalty calculation issue." The objections also include relevance, overbreadth, and vagueness. See Responses and Objections, attached as Exhibit E.

The letter of November 11, 2004, brings into sharp focus the difference between the parties. Kinder-Morgan is willing to reveal some contracts and how it mathematically applies volumes of CO_2 to contract terms to "calculate" royalty. Of course, royalty "calculation" follows mechanically from the CO_2 prices and it is those "prices" from suspect contracts which are the real bone of contention. Plaintiffs challenge the very validity and economic rationality of the numbers that Kinder-Morgan uses. Plaintiffs also observe facts in the public domain and in the limited discovery to infer that some, if not all, Kinder-Morgan's CO_2 sales contracts are actually made pursuant to an agenda to circumvent the *Feerer* Settlement Agreement terms and to provide cover for its Bravo Dome and McElmo Dome CO_2 used in-kind. **In short, Kinder-Morgan wants to limit the investigation to its mechanical calculations and plaintiffs want to go deep behind the numbers used in the calculation.**

II. ARGUMENT

A. The Discovery Standard

In New Mexico, the "pretrial discovery rules, including Rule 26, intend a liberal pretrial discovery, to enable the parties to obtain the fullest possible knowledge of the facts before trial. Notwithstanding objection to the [requested discovery], the presumption is in favor of discovery." *Marchiondo v. Brown,* 98 N.M. 394, 397, 649 P.2d 462, 465 (1982). *Accord Lewis v. Samson*, 1999 NMCA 145, 128 N.M. 269, 276, 992 P.2d 282, 289 (Ct. App. 1999). The Supreme Court has noted that this liberal scope of discovery is as broad under Rule 1-034, respecting the production of documents, as it is under Rules 1-026 and 1-033. *Davis v. Westland Dev. Co.*, 81 N.M. 296, 299, 466 P.2d 862, 865 (1970). In *United Nuclear Corp. v. Gen. Atomic Co.,* 96 N.M. 155, 174, 629 P.2d 231, 250 (1980), the Supreme Court also noted:

> 'Objections based on alleged irrelevancy must, therefore, be viewed in light of the broad and liberal discovery principle consciously built into' the rules of civil procedure. . . . Because courts 'are not shackled with strict interpretations of relevancy,' . . . discovery is permitted as to matters that 'are or may become relevant' or 'might conceivably have a bearing' on the subject matter of the action, or where there is 'any possibility' or 'some possibility' that the matters inquired into will contain relevant information.

Id. (citations omitted) (footnotes omitted).

A party opposing discovery has the burden of proving that the requested discovery should be disallowed. *Josephs v. Harris Corp.*, 677 F.2d 985 (3rd Cir. 1982); *Roseberg v. Johns-Manville Corp.*, 85 F.R.D. 292 (E.D. Pa. 1980). A

mere statement by a party that a request for production is overly broad, burdensome, oppressive and irrelevant is inadequate to voice a successful objection. *Id.* The party resisting discovery must show specifically how each request is not relevant, or how each question is overly broad, burdensome or oppressive. *Oleson v. K-Mart Corp.*, 175 F.R.D. 560 (D. Kan. 1997); *Peat, Marwick, Mitchell & Company v. West*, 748 F.2d 540 (10th Cir. 1984).

Kinder-Morgan's objections to relevance, overbreadth and vagueness are merely standard, stock objections to discovery, unsupported by any proof. Consequently, the Court should rule that the stock objections are invalid and do not support Kinder-Morgan's refusal to produce relevant documents.

B. The Documents Requested Are Discoverable

1. The Issue Posed by Kinder Morgan's Motion to Compel Arbitration

Kinder-Morgan's Motion to Compel Arbitration is based on Section 16 of the Feerer Settlement Agreement. The arbitration provision is narrowly drawn. It pertains only to disputes regarding prices in Non-Qualified Contracts and Non-Qualified Other Transportation Charges. Plaintiffs' dispute prices under Non-Qualified Contracts, but they do so within the challenge to the overall policy by Kinder-Morgan and others to circumvent the Settlement Agreement and to artificially depress the payments to the royalty owners.

The primary thrust of the complaint is that Kinder-Morgan has breached the Feerer Settlement Agreement in the manner and method by which it fails to honor its royalty obligations. The Settlement Agreement expressly

excludes future claims for breach of the Settlement Agreement from the arbitration provision. None of the claims articulated in the Class Action Complaint are expressly reserved for arbitration in the Settlement Agreement. Similarly, plaintiffs' complaint regarding the net-back pricing methodology Kinder-Morgan utilizes to determine royalty obligations is not subject to the arbitration provision of the Feerer Settlement Agreement.

While the class action lawsuit in this case attacks the price upon which Kinder-Morgan calculates royalties, and while that price involves, to some extent, the price for sales under Non-Qualified Contracts, the attack on Kinder-Morgan's royalty payments is much broader. The "price" under contracts made with other CO_2 producers/ injectors is inextricably intertwined with the challenged conduct.

Kinder-Morgan's objection to the requests for production served by plaintiffs rests upon the pendency of its Motion to Compel Arbitration. Plaintiffs have previously established why the narrow, limited arbitration provision in the *Feerer* Settlement Agreement does not compel arbitration of the claims in this class action lawsuit. Even if the Court were to ultimately determine that some narrow issues are arguably within that arbitration provision, this case in its entirety must ultimately be presented to a jury as the trier of fact for a determination as to whether Kinder-Morgan breached the *Feerer* Settlement Agreement by failing to pay royalties on a proper valuation for CO_2 produced from the unit. Such claims are expressly excluded from arbitration under paragraph 16 of the *Feerer* Settlement Agreement. Consequently, there is no justifiable basis for Kinder-Morgan to object to the

subject discovery because of its pending Motion to Compel Arbitration.

2. Kinder-Morgan's Scheme to Depress Royalty Payments.

Under the *Feerer* Settlement Agreement, Kinder-Morgan is obligated to pay a "proper" royalty for CO_2 produced from the Bravo Dome Unit. Under that agreement, the parties specified that prices received under specifically enumerated contracts (Qualified Contracts) were appropriate or proper. With respect to other contracts, called "Non-Qualified Contracts" under the *Feerer* Settlement Agreement, the parties reserved judgment on whether the prices and royalty based thereon were proper. Given the covenant of good faith it must be assumed that the intent of that provision was to cover legitimate, arm's length Non-Qualified Contracts.

There is no express formula in the Settlement Agreement for determining whether a price is or is not proper. The logical measure of the CO_2 value, however, is the value of the crude oil and natural gas that but for the CO_2 would remain in the ground.

Following execution of the *Feerer* Settlement Agreement in April 1998, Kinder-Morgan has entered into numerous contracts for the "sale" of CO_2 produced from the Unit and amended other contracts. The sales are primarily made to other operators who also own CO_2 production in the Bravo Dome Unit and the McElmo Dome Unit in Southwest Colorado. Each of them have need for their CO_2 in their own EOR projects. The evidence produced to date points to some sales as being subterfuges by which the sellers end up with the CO_2, a fungible commodity that is

transported from all source fields to a single central pipeline hub at Denver City. The commingled CO_2 from McElmo Dome, Sheep Mountain and Bravo Dome is then transported by lateral lines to various EOR projects. There seems to be no commercial rationale for Kinder-Morgan to sell CO_2 which it needs for its own EOR projects. No rationale that it is other than a means for the CO_2 producers to circumvent the Settlement Agreement and fix the prices for royalty and tax payment purposes.

When Kinder-Morgan sells all its CO_2 it then has to "purchase" from the same companies it is "selling to" in order to secure an adequate supply of CO_2 for its SACROC and Yates Field Projects. The available evidence suggests that these "contracts" are in fact attempts by various CO_2 producers to artificially deflate the price of CO_2 upon which they then pay royalties. This is possible because the primary CO_2 producers Kinder-Morgan, Oxy, ExxonMobil and Amerada Hess Corporation are also the primary end users of CO_2 for oil production.

In addition, documents Kinder-Morgan has produced to date already confirm that there are irregularities in Kinder-Morgan's accounting process. For instance, the June, 2000 Post Settlement statement attached as an exhibit to Kinder-Morgan's Motion to Compel Arbitration shows two categories of sale to Amerada Hess, one under contract 34625-202E, and one under 34625-223A. On the Post Settlement sheet, Kinder-Morgan represents that no volumes were included under either contract. As to 202E, Kinder-Morgan represents that it is "not included in royalty calculation because Cross Timbers took product from Bravo and sold to KM." As to 223A, a zero volume is depicted. See documents attached hereto as Exhibit F. However, attached hereto as Exhibit G is an invoice from

Kinder-Morgan to Amerada Hess for the delivery of CO_2 to the Seminole San Andres Unit ("SSAU"), under the same meter number, 34625,[1] for a volume of 154,497 Mcf of CO_2, for a total amount due of $165,761.84.

Kinder-Morgan has gamed the system to derive an artificially low price for the gas at the Unit. At its EOR projects Kinder-Morgan injects CO_2. It could (and in reality does) inject its own CO_2 ("in-kind supplies") which generally amount to the major portion of the volumes used. Since Kinder-Morgan and other Unit working interest owners are using their own commodity the only significance of CO_2 "prices" under the various contracts appear to be to provide a measure for royalty and taxes.

The obvious incentive of the defendant is to keep the CO_2 "price" low. Not only does Kinder-Morgan steadfastly argue that those prices they concoct, less deductions for their own charges for mainline transportation services, are the proper measure of royalty, it even contends by its discovery objections that those "prices" are the be all and end all of relevant evidence. In other words, Kinder-Morgan's relevancy objection says that the plaintiffs, the Court and the jury are only entitled to evidence Kinder-Morgan selects to produce, calculation summary sheets and the contracts. This approach deprives plaintiffs' of evidence which will support plaintiffs' theory of proper CO_2 value and of the nonarbitrability of the issues in this case.

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[1] The number 34625 appears to designate the measurement meter at the tailgate of the Bravo Dome Unit compression plant while 202E and 2223A are contract identifiers.

3. Documents Related to Kinder-Morgan's EOR Protects are Discoverable.

Request No. 10 seeks documents regarding sales of CO_2 from McElmo Dome, another CO_2 unit, as well as contracts related to such sales. Kinder-Morgan owns a 45% interest in the CO_2 in McElmo Dome, which it needs for its EOR projects.

Request No. 11 seeks any contract for CO_2 produced for any EOR project which references a sale of CO_2 by Kinder-Morgan.

Request No. 12 seeks the production of contracts concerning unit produced and McElmo Dome produced CO_2. It seeks evidence of in-kind delivery and of CO_2 delivered to the SACROC Unit from Kinder-Morgan before the defendant became 80% owner and operator of that granddaddy EOR field. Request No. 15 seeks documents reflecting CO_2 delivered or sold to Altura-operated EOR projects. Altura is the entity that operates certain of Oxy USA's EOR fields.

All of these requested documents are relevant, to help establish the true value for CO_2 upon which royalties should be paid. Moreover, these documents are relevant to demonstrate the manner and method by which Kinder-Morgan and other CO_2 royalty obligors circumvent and breach the Settlement Agreement. The contracts between the CO_2 producers/users are subject to attack as to their very legitimacy, not just as to the facial price.

Because of the absence of a workable market and a lack of arms' length transactions, the economics of the Unit, as well as of Kinder-Morgan's EOR projects must all be examined. Evidence of any arms length sales to third

parties that do reflect a seller and buyer with true competing economic interests would also be relevant. That evidence is being sought by plaintiffs.

By analogy cases recognizing that where self-dealing among dominant working interest owners and their affiliated companies is shown the royalty calculation is not limited to the proceeds derived from non-arms' length transactions are applicable. For example, in *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24 (Tex. App. – Texarkana 1984), *vacated pursuant to settlement*, 760 S.W.2d 960 (Tex. 1988), the Texas Court of Appeals held that the price paid by the lessee's wholly owned subsidiary for gas sold at the well was not controlling for purposes of a royalty clause based on "amount realized" from such sale, affirming the trial court's finding that "the purported sale of the gas to [the subsidiary] was a sham, and that [the lessee] used that arrangement and its relationship with its wholly owned subsidiary to create an unfair device to deprive plaintiffs of their rightful royalties." *Id.* at 28. The court further held that the royalty owners thus "were entitled to recover as actual damages the difference between what they had paid and the market value of the gas. . . ." *Id.* at 29.

Similarly, in *Wegman v. Central Transmission, Inc.*, 499 So. 2d 436, 441, 443, 448-49 (La. Ct. App. 1986), the Louisiana Court of Appeals held that the prices at which the lessees sold gas at the well to their affiliated company under contracts that "were not 'arms-length agreements,'" but which "created an artificial market value for gas," were therefore not controlling for purposes of computing royalty under an "amount realized" royalty clause; and the royalty owners were entitled to royalties based on actual market value, which was proven by expert testimony.

It is therefore clear that this case involves a search for the truth behind the Non-Qualified Contracts as well for the true market value of the CO_2 from the Unit. And, given that the Unit CO_2 is primarily used to increase oil production in defendants' EOR projects, the revenues, expenses and profits generated by those projects have a direct bearing on the CO_2's value and are therefore relevant. The Tenth Circuit, for example, has recognized that the value of a product or property can be determined by analyzing the income generated by its use. *U.S.A. v. 179.26 Acres of Land,* 644 F.2d 367, 372 (10th Cir. 1981); *Sill Corp. v. U.S.A.,* 343 F.2d 411, 416 (10th Cir. 1965) ("[T]he law is not wedded to any particular formula or method for determining fair market value . . . ")

Where, as here, there is no established market for the commodity, the courts have been especially willing to look to every relevant factor and alternative methods for determining value, including income and other factors related to the use of the product. In *Sartor v. Arkansas National Gas Corp.,* 321 U.S. 620, 622 (1944), the Supreme Court stated, "if there is no market price at the well for the gas, [the inquiry shall determine] what it is actually worth there, and 'in determining this actual value . . . every factor properly bearing upon its establishment should be taken into consideration.'" In New Mexico law a consideration in ascertaining the fair market value of property is the use for which the property is suitable. *McCanna v. Burke, Trustee*, 197 B.R. 333, 1996 U.S. Dist. LEXIS 9133 (D.N.M. 1996); UJ1 13-711.

In *Katschor v. Eason Oil Co.*, 63 P.2d 977, 981 (Okla. 1936), the Oklahoma Supreme Court held that, under a market value royalty clause for casinghead gas used by the lessee in its gasoline plant, because there was no

established market price for casinghead gas, the royalty should be based on the "actual value" of the gas, which the royalty owners could prove based on the price paid to the lessee for the gasoline manufactured using the casinghead gas.

4. Documents Involving Communications Between Kinder-Morgan and Other Working Interest Owners that Refer to Pricing of CO_2 are Relevant.

Request No. 13 seeks all internal Kinder-Morgan files, as well as documents referencing communication between Kinder-Morgan and third parties that "reflect, discuss, refer to or concern the pricing of Unit CO_2 and the method of calculating royalty payments to any unit lessor or overriding royalty holder." The relevance of these documents is self-evident. Plaintiffs are entitled to all documents in Kinder-Morgan's possession related to this issue, since internal file documents and communications with third parties may well confirm plaintiffs' charge that Kinder-Morgan is intentionally undervaluing the CO_2 for royalty calculation purposes. Indeed, these documents clearly have a bearing on the royalty calculation, and are documents which Kinder-Morgan had agreed to produce in principle.

Request No. 14 is particularly meaningful in that subparts (b) and (c) seek to uncover communications between Kinder-Morgan and other working interest owners in Bravo Dome and McElmo Dome about valuing CO_2 and making their transactions that superficially are sales but actually are exchanges of the gas. Subpart (d) calls for economic studies or models concerning the pricing

of CO_2 in relation to return on investment and economics of EOR projects.

Kinder-Morgan has produced some contracts. More importantly, however, plaintiffs are entitled to all documents which underlie and surround the formation of those contracts. Starting with documents and then progressing to deposing witnesses the facts must be out on how the contracts were negotiated, the reality of the sales or exchanges, how the prices were determined, whether there was collusion or price setting by Kinder-Morgan and other royalty obligors, all in order to allow plaintiffs to fully investigate the CO_2 sales (if they are sales). Any studies, analyses or models that deal with the pricing of CO_2 are clearly relevant to the central issue and to allow the plaintiffs and the factfinder in this case to compare these analyses and models with the actual prices that Kinder-Morgan has used to calculate royalties.

Request No. 16 is similarly relevant. That request seeks documents in the form of bids, offers or proposals to sell or otherwise supply CO_2 to third parties for use in EOR projects and requests for proposals, requests for bids or inquiries from the working interest owners in EOR projects to Kinder-Morgan about the purchase or delivery of CO_2. These documents can provide interesting information such as sales to parties who have no CO_2 of their own as opposed to sales to the likes of other large CO_2 producers. They may demonstrate the true nature of some of sales contracts and demonstrate that Kinder-Morgan has joined with others to administer prices to fit their financial objectives.

III. CONCLUSION

Based on the foregoing points and authorities, plaintiffs respectfully request that the Court enter its Order compelling Kinder-Morgan to produce all documents responsive to Requests 10-16, and for such further relief as the Court deems proper.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused a true and correct copy of the foregoing Memorandum in Support of Plaintiffs' Motion to Compel No. 1 – Documents Related to the Formation of Sales Contracts, the Value and Prices of Unit

CO2 to be served on this 10th day of December, 2004, to the following counsel of record:

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VIA HAND-DELIVERY

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VIA U.S. MAIL

/s/ J.E. Gallegos
J.E. Gallegos

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

DORIS FEERER, MARTIN BROTHERS, a partnership, J. CASPER HEIMANN, MALCOLM SMITHSON, and CHRISTINE SMITHSON, his wife,	§	
Plaintiffs,	§	
vs.	§	Civ. No. 95-0012 JC/WWD
AMOCO PRODUCTION COMPANY, AMERADA HESS CORPORATION, SHELL WESTERN E&P INC., and EXXON CORPORATION,	§	
Defendants.	§	

CLASS ACTION SETTLEMENT AGREEMENT

(Filed Apr. 1, 1998)

It is hereby stipulated and agreed between the Plaintiffs Doris Feerer, Martin Brothers, J. Casper Heimann, and Malcolm and Christine Smithson, individually and on behalf of the Class (as hereinafter defined), on the one hand, and Defendants Amoco Production Company, Amerada Hess Corporation, Shell Western E&P Inc., and Exxon Corporation, as well as Shell CO2 Company Ltd. (which is not a party to the Action), on the other, through their, duly authorized counsel or representatives, and subject to court approval in accordance with the procedures described herein and pursuant to the applicable Federal Rules of Civil Procedure, as follows:

A. BACKGROUND

1. Plaintiffs, on behalf of themselves and the Class, filed a lawsuit on January 5, 1995, against Defendants Amoco Production Company, Amerada Hess Corporation, Shell Western E&P Inc., and Exxon Corporation in the United States District Court for the District of New Mexico, styled *Doris Feerer, et al. v. Amoco Production Company, et al.*, Civil Action No. 95-0012JC/WWD, asserting claims based on alleged violations of antitrust laws, breach of contract, breach of duty of good faith and fair dealing, breach of implied covenant to market, fraud, negligent misrepresentation and unjust enrichment. The claims asserted by the Plaintiffs in the Action on behalf of themselves and the Class are more fully set forth in the Original and the First, Second and Third Amended Complaints, copies of which are attached as Exhibit A (hereinafter collectively the "Complaints").

2. The Defendants have each filed answers to the Complaints, denying any and all allegations of wrongdoing set forth therein, and alleging certain affirmative defenses. Copies of each of the Defendants' answers to the Third Amended Complaint are on file with the Court in the Action.

3. Before and after the filing of this Action, Class Counsel (as hereinafter defined) conducted extensive formal and informal discovery and investigation. This discovery and investigation has included, *inter alia*, (a) the inspection of hundreds of thousands of pages of documents produced by Defendants and third parties; (b) the promulgation and response to numerous written discovery requests, including interrogatories, requests for production of documents, and requests for admissions; (c) the taking

and defense of approximately one hundred (100) depositions; (d) the engagement of numerous experts to analyze various issues, who have prepared extensive reports; (e) the preparation and review of hundreds of pleadings filed in the Action; and (f) research of applicable law with respect to the claims asserted in the Action and the potential defenses thereto.

4. Class Counsel believe that the claims asserted in the Action have merit and are supported by the evidence developed to date. Class Counsel, however, recognize and acknowledge the risks and uncertainties inherent in prosecuting any action and the expense and length of continued proceedings necessary to prosecute this Action against Defendants through trial and appeals. Class Counsel believe that the Settlement set forth in this Agreement confers substantial and significant benefits to the Class. Accordingly, based upon their evaluation and as a result of arms length negotiations with Defendants, which have been conducted both formally and informally and pursuant to settlement conferences, Class Counsel have determined that the terms and conditions of this Settlement are fair, reasonable, adequate, and in the best interests of the Class.

5. Defendants vigorously contest and continue to deny each and all of the claims and contentions alleged by the Plaintiffs and the Class, which Defendants assert are without merit. The Defendants vigorously deny that they have violated any law or regulation, or breached any agreement or duty, or are in any way liable to the Plaintiffs or any member of the Class. Defendants believe that the evidence developed to date does not support the claims of Plaintiffs and the Class and that the affirmative defenses they have asserted are supported by the evidence.

Nevertheless, the Defendants have entered into this Agreement solely because they believe it will avoid the further substantial expenses, inconvenience and distraction of continued litigation. Defendants have also taken into account the uncertainty and risks inherent in any litigation, especially in complex cases like this Action. Defendants have, therefore, determined that it is desirable and beneficial that the Action be settled in the manner and upon the terms and conditions set forth in this Agreement.

6. Accordingly, subject to court approval in accordance with the procedures described hereinafter and pursuant to the applicable rules of procedure, the Parties agree to settle and dispose of this Action on the terms and conditions hereinafter set forth.

* * *

9. As a part of the consideration for this Settlement, the Parties further agree, as between each Defendant and its Respective Owners to the following provisions with respect to Unit Compression, Dehydration, and Gathering for purposes of determining their respective royalty settlement values and payment of royalty to their Respective Owners:

9.1 Effective for production of Unit CO2 occurring on July 1, 1997 and thereafter, Exxon shall not deduct any costs of Unit Compression, Dehydration and Gathering in calculating royalty payments to Exxon Owners.

9.2 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, Amoco, Hess, and Shell shall not deduct any costs of Unit Compression, Dehydration, and

Gathering in calculating their respective royalty payments to their Respective Owners.

9.3 Pursuant to paragraphs 9.1 and 9.2, and after the applicable time period begins, Defendants shall not adjust or reduce their respective royalty payments to their Respective Owners for costs of Unit Compression, Dehydration and Gathering by any method, direct or indirect, As example only, for Unit CO2 that undergoes Unit Compression, Dehydration and Gathering, Defendants shall not calculate their respective royalty settlement values for royalty payments to their Respective Owners on the basis of a sale or delivery point at the physical locations of the wellheads on the Unit or at a point otherwise upstream of the Unit Tailgate. As further example only, if any of the Defendants sell Unit CO2 and the buyer is separately charged for Unit Compression, Dehydration and Gathering, the amount of payment received by any Defendant for such Unit Compression, Dehydration, or Gathering activities shall not be excluded from the amounts received for the sale of the Unit CO2 for the purpose of calculating royalty due to such Defendant or Defendants' Respective Owners. As further example only, costs of Unit Compression, Dehydration and Gathering shall not be included as a part of any deduction associated with the transportation of Unit CO2 for the purpose of calculating royalty due to the Defendants' Respective Owners.

10. Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, for purposes of determining their respective royalty settlement values and payment of royalty to their Respective Owners, Defendants shall not, directly or indirectly, deduct a marketing fee. The foregoing also means, as example only, that Amoco shall not deduct a marketing fee in calculating the sales

price under the Amoco Production-Amoco Oil Contract, Nothing herein shall constitute an acknowledgment that any marketing fee has been charged in the past by Exxon or Shell.

11. Effective as of the identified dates, the following provisions shall govern the transportation deductions specified below, for purposes of the indicated Defendant's determinations of their respective royalty settlement values and payment of royalty to their Respective Owners:

11.1 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, and only for purposes of Amoco calculating royalty payments to Amoco Owners (subject to paragraph 17), the following provisions shall govern the specified deductions or adjustments for mainline transportation of Unit CO2 in the Bravo Pipeline System:

(a) With respect to volumes of Unit CO2 taken by Amoco attributable to its working interests in the Unit, whether equal to, less than or more than its entitlements, and transported on space in the Bravo Pipeline System owned by Amoco or its Affiliates. (including without limitation Bravo Pipeline Company and Altura Energy, Ltd.), or successors, successors-in-interest and assigns which are Amoco Affiliates (hereafter collectively the "Amoco Companies"), from the Unit Tailgate to the Terminus Point, or to any point between the Terminus Point and a point 75 miles upstream of the Terminus Point, Amoco shall be entitled to deduct for such transportation the lesser of (i) 11¢ per mcf, or (ii) the tariff or amount actually charged for the Amoco Companies' space in the Bravo Pipeline System (hereinafter the "Amoco Approved Mainline Deduction"). The Amoco Approved Mainline Deduction shall be inclusive of all

services and charges (such as, as example only, charges for the Lost Draw Booster Station) that have been historically treated as a part of the Bravo Pipeline mainline tariff previously charged for transportation of Unit CO2 from the Unit Tailgate to the Terminus Point. The Amoco Approved Mainline Deduction shall not be inclusive of any service or charge that historically has not been treated as part of the Bravo Pipeline mainline tariff previously charged for transportation of Unit CO2 from the Unit Tailgate to the Terminus Point.

(b) With respect to volumes of Unit CO2 taken by Amoco attributable to its working interests in the Unit, whether equal to, less than or more than its entitlements, and transported on the Amoco Companies' space in the Bravo Pipeline System to a delivery point or points on such pipeline located more than 75 miles upstream of the Terminus Point, then the 11¢ per mcf limitation (or the lesser tariff or amount actually charged) in (a) above shall be reduced by the ratio that the distance in miles from the origination point of the Bravo Pipeline System to the delivery point bears to the distance in miles from the origination point of the Bravo Pipeline System to the point 75 miles upstream of the Terminus Point, and such reduced amount shall be utilized in lieu of the 11¢ limitation (or the lesser tariff or amount actually charged) provided for in subparagraph 11.1(a) above.

(c) The above provisions mean, as example only, that, for purposes of calculating its royalty settlement values for royalty payments to Amoco Owners for Unit CO2 taken by Amoco attributable to its working interests in the Unit, whether equal to, less than or more than its entitlements, and transposed on the Amoco Companies' space in the Bravo Pipeline System, Amoco shall not deduct a Bravo Pipeline mainline tariff greater than 11¢ per mcf for deliveries

to the Terminus Point in calculating the sales price of Unit CO2 under the Amoco Production-Amoco Oil Contract, or deduct for mainline transportation on the Bravo Pipeline System an amount greater than the Amoco Approved Mainline Deduction for hauls to the Terminus Point or greater than the reduced Amoco Approved Mainline Deduction (For hauls to a point or points more than 75 miles upstream of the Terminus Point).

11.2 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, and only for purposes of Hess and Shell calculating royalty payments to Hess' and Shell's Respective Owners (subject to paragraph 17), the following provisions shall govern the specified deductions or adjustments for transportation of Unit CO2 in the Rosebud/Sheep Mountain Pipeline and the Bravo Pipeline System:

(a) With respect to volumes of Unit CO2 taken by Hess or Shell attributable to their respective working interests in the Unit, whether equal to, less than or more than their respective entitlements, and transported (i) on space in the Rosebud/Sheep Mountain Pipeline owned by Hess or its Affiliates, or successors, successors-in-interest and assigns which are Hess Affiliates (hereafter collectively the "Hess Companies"), from the Unit Tailgate to the Seminole San Andres Unit ("SSAU") or to any point between SSAU and a point located on the Rosebud/Sheep Mountain Pipeline seventy-five (75) miles upstream of the Terminus Point (as to Hess volumes), or (ii) on space in the Bravo Pipeline System owned by Shell or its Affiliates (including without limitation Shelf Western Pipelines Inc.) or Altura Energy, Ltd., or successors, successors-in-interest and assigns which are Shell Affiliates (hereafter collectively the "Shell Companies"), from the Unit Tailgate to the Terminus Point or to

any point between the Terminus Point and a point 75 miles upstream of the Terminus Point (as to Shell volumes), a mainline transportation deduction of 11¢ per mcf shall be utilized (hereinafter the "Hess/Shell Approved Mainline Deduction"), The Hess/Shell Approved Mainline Deduction shall be inclusive of all services and charges (such as, for example only, charges for the Lost Draw Booster Station as to the Bravo Pipeline System) that have been historically treated as the mainline deduction or charge previously applied with respect to Unit Tailgate to SSAU transportation (with respect to Hess' space in the Rosebud/Sheep Mountain Pipeline) and the Unit Tailgate to the Terminus Point transportation (with respect to the Shell Companies', space in the Bravo Pipeline System). The Hess/Shell Approved Mainline Deduction shall not be inclusive of any service or charge that historically has not been treated as part of the mainline deduction or charge previously applied with respect to Unit Tailgate to SSAU transportation (with respect to Hess' space in the Rosebud /Sheep Mountain Pipeline) and Unit Tailgate to the Terminus Point transportation (with respect to the Shell Companies' space in the Bravo Pipeline System).

(b) With respect to (i) volumes of Unit CO2 taken by Hess attributable to its working interest in the Unit, whether equal to, less than or more than its entitlements, and transporter on the Hess Companies' space in the Rosebud/Sheep Mountain Pipeline, or (ii) volumes of Unit CO2 taken by Shell attributable to its working interest in the Unit, whether equal to, less than or more than its entitlements, and transported on the Shell Companies' space in the Bravo Pipeline System to a delivery point or points on such pipelines located more than 75 miles upstream of the Terminus Point, then the Hess/Shell Approved Mainline Deduction shall be

reduced by the ratio that the distance in miles from the origination point of the Rosebud/Sheep Mountain or the Bravo Pipeline System to the delivery point bears to the distance in miles from the origination point of the pipeline to the point 75 miles upstream of the Terminus Point on such pipeline, and such reduced Hess/Shell Approved Mainline Deduction shall be utilized in lieu of the 11¢ provided for in subparagraph 11.2(a) above.

(c) The above provisions mean, as example only, that Hess and Shell shall not, for purposes of calculating their respective royalty settlement values, deduct for mainline transportation with respect to volumes taken by Hess or Shell attributable to their respective working interests, whether equal to, less than or more than their respective entitlements, and transported in the Hess Companies' or the Shell Companies' respective space, as applicable, in the Rosebud/Sheep Mountain or the Bravo Pipelines, in an amount greater than the Hess/Shell Approved Mainline Deduction for hauls to the Terminus Point (or for hauls to SSAU, in the case of Hess) or greater than the reduced Hess/Shell Approved Mainline Deduction (for hauls to a point or points more than 75 miles upstream of the Terminus Point).

11.3 Amoco, Hess and Shell may not avoid the limitations in paragraphs 11.1 and 11.2 by entering into transactions within the scope of paragraphs 11.1 and 11.2: (a) with their respective Affiliates or, as to Shell, Altura Energy, Ltd., which result in a greater effective transportation deduction or differential than those approved under paragraphs 11.1 and 11.2; or (b) with non-Affiliates which (i) are designed to avoid or circumvent the limitations on transportation deductions described in paragraphs 11.1 and 11.2, and (ii) result in a greater effective transportation

deduction or differential than those approved under paragraphs 11.1 and 11.2. Nothing herein shall prohibit Amoco, Hess and Shell from entering into non-Affiliate transactions which are not designed to avoid or circumvent the limitations on transportation deductions in paragraphs 11.1 and 11.2 regardless of whether such transactions result in transportation deductions for royalty settlement purposes to their Respective Owners greater than those approved in paragraphs 11.1 and 11.2. This provision is intended only to prohibit the use by Amoco, Hess or Shell of a transportation deduction or differential resulting from the type of transaction described in this paragraph 11.3 in deriving their respective royalty settlement values and paying royalty to their Respective Owners. Any claim that Amoco, Hess or, Shell have entered into such a transaction and have used such deduction or differential in deriving their respective royalty settlement values shall be considered to be one for breach of the Settlement Agreement and not subject to mandatory arbitration under paragraph 16 below. It shall be a complete defense to any such claim that the transportation deduction or differential utilized does not exceed the transportation deductions described in paragraphs 11.1 and 11.2 above.

11.4 Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, with respect to volumes of Unit CO2 taken by a Defendant or Defendants attributable to their respective working interests in the Unit, whether equal to, less than or more than their respective entitlements, and transported to the Postle Connection Point, such Defendant or Defendants shall not, directly or indirectly, utilize any transportation allowance or charge for such transportation in calculating their respective

royalty payments to their Respective Owners. This means, as example only, that the Defendants shall not, for purposes of calculating their respective royalty payments to their Respective Owners, deduct any charge for transportation up to the Postle Connection Point, and the price or value of any Unit CO2 sold or exchanged by Defendants shall include, for purposes of calculating their respective royalty payments to their Respective Owners, any amount charged for transportation of such Unit CO2 from the Unit Tailgate up to the Postle Connection Point, irrespective of the point of sale or exchange between the selling or delivering Defendant or Defendants and the buyer or other party. Nothing herein shall constitute any acknowledgment that Exxon, Hess or Shell has made any charge of the type described above.

11.5 Nothing in this Agreement shall be construed to obligate Amoco, Hess or Shell to pay royalties to their Respective Owners on volumes of Unit CO2 other than those described in paragraph 14(a) below.

12. Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, the sales price under the 1994 Contract shall not be used by Defendants as a basis or benchmark for calculating their respective royalty payments to their Respective Owners. The price used by Amoco in calculating royalties for volumes delivered under such contract shall be based on the volume weighted average price obtained by Amoco for Unit CO2 under its other sales or dispositions. Nothing herein shall constitute any acknowledgment that Exxon and Shell used the 1994 Contract as a basis or benchmark for calculating royalty payments.

13. Effective for production of Unit CO2 occurring on January 1, 1998 and thereafter, each Defendant shall not, for purposes of calculating its respective royalty settlement values to be utilized in accounting to its Respective Owners, use a Unit weighted average price that includes the royalty settlement values for the volumes of Unit CO2 disposed of by other Defendants or other working interest owners in the Unit obtained in their sales or other dispositions from the Unit; provided, however:

(a) The foregoing prohibition is not intended to alter or affect the provisions of the Unit Agreement or other applicable contracts, if any, to which members of the Class are parties, concerning the allocation of Unit CO2 to the Defendants' Respective Owners.

(b) The Parties acknowledge that Defendants shall be entitled to continue, alter, effect or enter into agreements or procedures among working interest owners in the Unit, which concern or adjust for the impact, exclusively as among the working interest owners, of disproportionate takes of Unit CO2 or of dispositions at different prices, provided that such agreements or procedures do not modify or impair the obligations of the Defendants owed to the Class under this Agreement. By way of example only, nothing in this Agreement shall preclude Defendants from cross-invoicing among the working interest owners in the Unit to adjust for disproportionate takes or dispositions by different working interest owners at different prices, or from providing working interest owners in the Unit with (or receiving from other working interest owners) volume, price and cost data for working interest owners in the Unit on a monthly basis or otherwise so that they may accomplish such cross-invoicing, or from providing or receiving such information so that they may pay

royalties to individuals and entities that are not Plaintiffs or members of the Class. Plaintiffs and the members of the Class will reasonably cooperate in implementation of the elimination of weighted average pricing as to Plaintiffs and members of the Class provided for in this paragraph 13, provided their rights hereunder are not impaired.

(c) Nothing herein shall prohibit each Defendant, in calculating royalties payable to its Owners, from using a volume weighted average of its own sales or other dispositions of Unit CO2, except as provided in paragraph 12.

14. Amoco, Hess and Shell, effective for Unit CO2 production occurring on and after January 1, 1998, will utilize the royalty settlement methodology and the identified benchmarks set forth in subparagraphs (a), (b) and (c) below for the purpose of calculating and paying royalty to their Respective Owners, which methodology, benchmarks and resulting payments are hereby agreed to and approved by Amoco's, Hess' and Shell's Respective Owners:

(a) Amoco, Hess and Shell will each pay royalty to their Respective Owners for volumes of Unit CO2 allocated pursuant to the Unit Agreement and any other applicable contracts (to the extent there are any to which any of the Owners are parties).

(b) Amoco, Hess and Shell will each pay royalty to their Respective Owners for the volumes referenced in subparagraph 14(a) on the basis of the volume weighted average of the prices for their respective sales or other dispositions of Unit CO2 that they separately dispose of or take in kind. The volume weighted average price shall be determined by Amoco, Hess and Shell, respectively, subject to the provisions of paragraphs 9.2 and 9.3, and 10 through 13 above,

and to all provisions of the Unit Agreement that are not altered or affected by the provisions hereof, including, without limitation, the minimum royalty provisions and any other unaffected provisions of Article 6 of the Unit Agreement.

(c) Subject to the provisions of subparagraph 14(j) below, Amoco, Hess and Shell will pay their Respective Owners for volumes, as provided in subparagraph 14(a), on the basis of the volume weighted average of their respective prices for Unit CO2, as provided in subparagraph 14(b), utilizing a net-back methodology to adjust their respective prices for sales or other dispositions occurring downstream of the Unit Tailgate, and utilizing the prices or values established in their respective Qualified Contracts (as defined in subparagraph 14(e)) that apply to the volumes of Unit CO2 sold or delivered under such Contracts, their respective transportation charges established as Qualified Other Transportation Charges (as defined in subparagraph 14(f)) to the extent they apply and govern the volumes transported, and their respective Approved Mainline Deductions or, as applicable, reduced Approved Mainline Deductions (as defined in paragraphs 11.1 and 11.2), to the extent they apply and govern the volumes transported. The foregoing shall apply, as to Amoco and Amoco Owners, to the, determination of the sales price under the Amoco Production-Amoco Oil Contract and similar arrangements, and the "price or value established" under such Contract, as used above, shall refer to the CO2 sales price as determined from the injection projects' CO2 contracts before adjustment or deduction. Subject to paragraph 11.4, the November 1, 1995 exchange contract between Amoco Oil Company and Mobil Exploration and Production is approved as a Qualified Contract as long as the price determined thereunder is established in accordance

with Amoco's current practice. Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or approved herein, or that future royalty payments resulting from the use of such benchmarks, are improper. Amoco, Hess and Shell, on the one hand, and Plaintiffs and members of the Class, on the other, intend, only, to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper.

(d) The Approved Mainline Deductions shall be those allowed in paragraph 11.1 above, as to Amoco, and in paragraph 11.2 above, as to Hess and Shell.

(e) Qualified Contracts, as to Amoco, Hess and Shell respectively, shall be those contracts listed in Exhibit D-1 (Amoco), D-2 (Hess) and D-3 (Shell).

(f) Qualified Other Transportation Charges, as to Amoco, Hess, and Shell respectively, shall be those charges for transportation or related services provided for under the contracts or other arrangements listed in Exhibit E-1 (Amoco), E-2 (Hess) and E-3 (Shell).

(g) Non-Qualified Contracts shall mean and include all contracts for the sale, exchange, or other disposition of CO2 entered into by Amoco, Hess, or Shell after the date of this Agreement or not listed in Exhibit D-1, D-2 or D-3.

(h) Non-Qualified Other Transportation Charges shall mean and include any charges for transportation or related services (other than, those covered in paragraphs 11.1, 11.2 and 11.4 hereof) provided for under contracts or new arrangements relating to Unit CO2 entered into by Amoco, Hess, or Shell

after the date of this Agreement, or under contracts or arrangements not listed in Exhibit E-1, E-2 or E-3.

(i) The approval as provided herein of prices or values established under Qualified Contracts shall extend for the term of such contracts and to those volumes governed thereby. The approval as provided, herein of charges as Qualified Other Transportation Charges shall extend and apply for the term of the contracts establishing the charge or during the period the arrangement(s) remain in effect that establish the charge. With regard to any amendments, changes, or extensions of Qualified Contracts or of contracts or arrangements establishing Qualified Other Transportation Charges occurring after the date of this Agreement and that extend the term of the contracts, affect the volumes covered, price to be paid or price formula to be utilized, or charge to be imposed or formula to be utilized in establishing such charge, such approval shall not extend or apply to the volumes affected by such amendments, changes, or extensions. Further, with respect to Amoco, the approval of Amoco's Qualified Contracts shall not include any additional injection projects or volumes that are included in the Amoco Production-Amoco Oil Contract after the date of this Agreement.

(j) Nothing herein shall constitute approval of or allow the deduction, directly or indirectly, of any cost that is prohibited or limited in paragraphs 9.2, 9.3, and 10 through 13 above. Nothing herein shall allow the use of the 1994 Contract as a Qualified or Non-Qualified Contract. It is acknowledged and agreed that, as between the Parties hereto, transportation charges and related services as used herein are not intended to include costs of Unit Compression, Dehydration, and Gathering. With respect to Non-Qualified Contracts and Non-Qualified Other Transportation Charges, nothing herein shall be construed

to affect or supplant any legal or contractual duties that may be owed by Amoco, Hess, or Shell to their Respective Owners in entering into contracts for the sale or other disposition of Unit CO2 and accounting for royalty thereon, or in incurring or establishing transportation charges or transportation deductions utilized in accounting for royalty, or to waive, impair or otherwise affect any future claims that may accrue in favor of the Owners relating thereto, including, but not limited to, any claim that a Non-Qualified Contract or Non-Qualified Other Transportation Charges relied upon in establishing royalty settlement values is improper for any reason.

15. Plaintiffs, members of the Class, and Amoco, Hess and Shell acknowledge and agree that nothing in paragraph 14 above is intended to modify or amend existing contractual relationships between Amoco, Hess or Shell and individuals or entities who are not Plaintiffs or members of the Class.

16. Any claims asserted by Plaintiffs or members of the Class against Amoco, Hess or Shell regarding (a) the price or value under Non-Qualified Contracts (or under amendments to or extensions of contracts establishing new prices or values under Qualified Contracts as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess, or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners and, (b) regarding Non-Qualified Other Transportation Charges (or amendments to or extensions of contracts or other arrangements establishing Qualified Other Transportation Charges as referenced in sub-paragraph 14(i) above) utilized by Amoco, Hess or Shell in establishing royalty settlement values for purposes of payment to their Respective Owners, shall be submitted to and decided by binding

arbitration pursuant to the following provisions. Within ten (10) days after notice by one party to the other of its demand for arbitration, which demand shall also set forth the matter or matters to be submitted and the name of its arbitrator, the other party shall name its arbitrator, identify any additional matter(s) to be submitted, and so notify the demanding party. Within ten (10) days thereafter the two arbitrators shall select a third arbitrator. The arbitrators shall decide the matters submitted within ninety (90) days of the completion of the hearing. The decision of any two of the three arbitrators shall be binding on the parties. In all other respects, arbitration shall be conducted in accordance with and pursuant to the Commercial Rules of the American Arbitration Association and judgment upon the award may be entered in any court having jurisdiction thereof. This provision concerning arbitration applies only to the claims identified in this paragraph 16 and shall, in no event, apply to any future claims for breach of this Agreement.

* * *

IN WITNESS WHEREOF, this Agreement has been executed by the undersigned as of the date set forth below.

Dated: March 31, 1998

[Signatures]

* * *

No. 07-164

FILED
OCT 29 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

In The
Supreme Court of the United States

KINDER MORGAN CO_2 COMPANY, L.P.,

Petitioner,

v.

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Respondents.

On Petition For Writ Of Certiorari To The Court Of Appeals Of The State Of New Mexico

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether Petitioner has presented compelling reasons to grant the Petition, where the New Mexico Court of Appeals Opinion is consistent with and faithfully applies decisions of this Court recognizing that arbitration is a matter of contract, and that parties are not obligated to arbitrate disputes they have agreed are not subject to arbitration, in light of the operative provision of the Feerer Settlement Agreement ("FSA") that provides "This provision concerning arbitration applies only to the claims identified in this paragraph 16 and shall, in no event, apply to any future claims for breach of this Agreement"?

II. Whether Petitioner has presented compelling reasons to grant the Petition, where the Petition is based on (a) a misconstruction of the approved royalty payment methodology and the arbitration provision set forth in the FSA, (b) a mischaracterization of the class action complaint, and (c) a misreading of the New Mexico Court of Appeals decision?

III. Whether Petitioner has presented compelling reasons to grant the Petition, where the Petition is based on the erroneous contention that the New Mexico Court of Appeals decision regarding the contract claims in the class action complaint was based solely on the narrow scope of the arbitration provision, and where there is no split in the circuits that requires review by this Court, because the universal rule is that the federal presumption in favor of arbitration cannot override an express agreement that a particular dispute is not subject to arbitration?

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INTRODUCTION

Petitioner Kinder Morgan CO_2 Company, L.P. ("Kinder Morgan") has presented no "compelling reason" for its Petition for a Writ of Certiorari ("Petition") to be granted. See Sup. Ct. R. 10. Three New Mexico courts have considered the same arguments advanced in the Petition and, after thorough briefing, a review of the record, and oral argument, have reached the same conclusion this Court will ultimately reach, i.e., that Royalty Owners' ("Royalty Owners") are not obligated to arbitrate breach of contract claims[1] where the operative agreement, the Feerer Settlement Agreement ("FSA"), expressly provides that the narrow arbitration provision "shall, in no event, apply to any future claims for breach of this Agreement." This result is mandated by the rule announced by this Court in *AT & T Technologies, Inc. v. Communications Workers of America,* 475 U.S. 643, 648 (1986), which held that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."

Kinder Morgan attempts to manufacture an issue of "exceptional importance under the Federal Arbitration Act" ("FAA"). It claims it has been deprived of its

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[1] The New Mexico Court of Appeals correctly recognized that the claims for royalty underpayment in the class action complaint based upon breach of contract, breach of the duty of good faith and fair dealing, and breach of the implied covenant to market, are contract-based.

"arbitration rights" under the FAA. There is no constitutional or statutory right to arbitration. Arbitration is a matter of contract between the parties. The parties here agreed that claims for breach of the FSA would not be subject to arbitration.

The Royalty Owners' claim for royalty underpayment is based on the fact that Kinder Morgan did not follow the approved methodology set forth in the FSA in calculating and paying royalties for carbon dioxide ("CO_2") produced from the Bravo Dome Unit in northeastern New Mexico. Respondents' Appendix ("Resp. App."), 5-6. The parties in the FSA approved certain contracts called Qualified Contracts for future royalty payments. The agreement provides that, absent some other agreement between the parties, all royalty payors, including Kinder Morgan, were required to pay royalty based upon approved contract prices under Section 14(c), using "the volume weighted average of their respective prices for Unit CO_2 as provided in 14(b), utilizing a net-back methodology . . . utilizing the prices or values established in their respective Qualified Contracts . . . that apply to the volumes of Unit CO_2 sold or delivered under such Contracts." Kinder Morgan did not and does not utilize a volume weighted average price under Qualified Contract prices to calculate royalties as specified by the FSA. The Royalty Owners have still not been able to determine whether and to what extent Kinder Morgan used Non-Qualified Contract prices, "other benchmarks", or some other values in calculating

royalty payments. The appellate proceedings have precluded merits discovery since 2005.

Kinder Morgan bases its case for arbitration on a narrow arbitration clause that calls for arbitration of disputes regarding prices or values under Non-Qualified (unapproved) Contracts. Pet. App. 102. There is no allegation in the complaint regarding Non-Qualified Contracts. The fact is that Royalty Owners did not know precisely how Kinder Morgan calculated royalties when the complaint was filed. They still do not know. The royalty remittance statements Kinder Morgan provides class members do not disclose the basis for the prices used by Kinder Morgan to calculate royalties. When the complaint was filed, the Royalty Owners did know that many of the Qualified Contracts tied the price of Unit CO_2 to the price of oil. During the period 2000-2004, as oil prices rose significantly, the price of Unit CO_2 reported by Kinder Morgan upon which royalties were paid fell.

Because it has no right to arbitration under the unambiguous language of Section 16 of the FSA, Kinder Morgan accuses the Royalty Owners of attempting to avoid the arbitration provision through "artful pleading." Kinder Morgan offers no evidence to support this accusation because there is no such evidence in the record.

Finally, Kinder Morgan attempts to manufacture out of whole cloth an alleged split in the federal circuits on the standard courts should apply to analyze narrow arbitration provisions. The implication is

that this Court needs to resolve the issue and settle the alleged sharp division between the circuits. Petition, pp. 14-18. Nothing could be further from the truth. While different courts may articulate the standard to determine arbitrability differently, they all apply the same standard substantively. There is no split. Even if there were, the alleged split in the circuits regarding the standard of review for narrow arbitration clauses is a false issue because the New Mexico Court of Appeals did not apply the more restrictive test or require proof that the claim is "on its face within the purview" of the arbitration clause in deciding the case below. The Court of Appeals ruling is right under any test of arbitrability.

Kinder Morgan focuses solely on the narrow arbitration provision of the FSA. The court below recognized that the FSA contains both a narrow arbitration clause *and* an express exclusion from arbitration for claims for breach of the FSA. The court below correctly held that the narrow arbitration provision could not trump the unambiguous exclusion clause, and that the federal policy favoring arbitration did not render that exclusion void or obligate the Royalty Owners to arbitrate disputes they did not agree to arbitrate. The FAA allows parties to exclude claims from arbitration even where they provide for arbitration as to a narrow class of disputes.

Kinder Morgan also contends that there is a conflict between the New Mexico Court of Appeals decision and the law of the Fourth Circuit. A review of the cases cited by Kinder Morgan demonstrates no

conflict. Even if there were a dispute between those jurisdictions, it would not present a compelling reason for review by this Court because New Mexico courts are not bound by Fourth Circuit precedent.

STATEMENT OF THE CASE

Nature of the Case.

The Royalty Owners filed this lawsuit individually and on behalf of a class of similarly situated private royalty and overriding Royalty Owners against Kinder Morgan to recover damages for underpayment of royalties based on production of carbon dioxide ("CO_2") from the Bravo Dome Unit ("Unit") in northeastern New Mexico.[2] The named plaintiffs Pecos Slope and Rio Petro were members of the class certified in *Feerer, et al. v. Amoco Production Company, et al.*, USDC Cause No. Civ. 95-0012

[2] The Royalty Owners initially filed a claim in arbitration against Kinder Morgan and an identical arbitration demand against OXY USA Inc., ("Oxy"), the Unit operator and largest Unit working interest owner. Because the Royalty Owners did not know how royalties were calculated, the arbitration filing was based on the assumption that corporate defendants would prefer arbitration to litigation. Oxy responded to the arbitration demand by filing a declaratory judgment action seeking a determination that the claims for royalty underpayment were based on breach of the FSA and were not subject to arbitration. The Royalty Owners then withdrew the arbitration demands and filed class action lawsuits. The claims against Oxy were resolved on the verge of a jury trial by settlement in October 2005.

(D.N.M. 1998) (*"Feerer"*), a prior federal class action lawsuit for royalty underpayment. Kinder Morgan is a successor to Shell CO_2 Company Ltd., a *Feerer* defendant and party to the FSA. Kinder Morgan has paid royalties to the Royalty Owners since January 2000. R.P. 199.

The Class Action Complaint alleges that Kinder Morgan breached the FSA and related implied covenants and underpaid royalties to the class, that Kinder Morgan failed to pay royalties in accordance with the FSA, that Kinder Morgan has "set 'prices' that are not formed by true market forces," and are grossly less than the value relative to the oil produced by Kinder Morgan using the CO_2, and that Kinder Morgan "has breached its contractual obligations and acted in bad faith by fabricating improper and dishonest 'prices' for Unit CO_2." Pet. App. 39-41. The complaint also asserts claims for constructive fraud and violation of the New Mexico Unfair Practices Act. Pet. App. 37-38. It seeks equitable relief in the form of accounting and injunction. Pet. App. 42-43. There is no allegation in the Complaint that references prices or values under Non-Qualified Contracts or Non-Qualified Other Transportation Charges. Pet. App. 27-44. The complaint does not even mention Non-Qualified Contracts.[3] Most of the CO_2 upon

[3] The Court of Appeals decision does reference that plaintiffs "contend that Kinder Morgan modified the parties agreed on methodology for calculating royalties, by using non-qualified contracts in the royalty calculations." Pet. App. 4. This is not the

(Continued on following page)

which Kinder Morgan is obligated to pay royalty is not bought or sold but is delivered in-kind for Kinder Morgan's own use.

Kinder Morgan filed a Motion to Compel Arbitration two months after the complaint was filed, and disclosed for the first time to the Royalty Owners some information on how it valued the Unit CO_2 for royalty purposes. Resp. App. 2-3. According to Kinder Morgan's expert, the regular monthly payment statements Kinder Morgan sends to the Royalty Owners with their checks do not reveal "when qualified contract number 3 was discontinued and was no longer being used," or whether "only qualified contracts were being used to arrive at the price." Resp. App. 54. Kinder Morgan submitted an expert report from an economist who analyzed Kinder Morgan's royalty payment methodology. The Royalty Owners then filed a Supplemental Response to the Motion with an affidavit from their expert challenging Kinder Morgan's royalty payment methodology and outlining Kinder Morgan's breaches of the FSA. Resp. App. 2-55.

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basis for the Royalty Owners' claims for breach of contract. This statement is contrary to other statements in the Court of Appeals decision that recognizes that "Plaintiffs may not dispute the prices under nonqualified contracts at all."

Summary of Material Facts.

The Bravo Dome Unit and CO_2 Production.

The Unit is situated in Harding, Union and Quay Counties, New Mexico. It is one of the largest carbon dioxide producing units in the United States and contains what is believed to be one of the largest accumulations of recoverable CO_2 reserves. Oxy is the unit operator with a working interest of about 75%. Kinder Morgan's working interest in the Unit is approximately 11%.

Once produced, Unit CO_2 is gathered, dehydrated and compressed at the Unit. The compressed CO_2 is then transported via pipeline to enhanced oil recovery ("EOR") projects in the Permian Basin in southeastern New Mexico and west Texas. Enhanced Oil Recovery refers to a method used to obtain incremental oil production from crude oil reservoirs over that which can be economically recovered in conventional primary and secondary recovery methods.

The CO_2 industry is vertically integrated. Kinder Morgan is one of the companies who have CO_2 supply and also operate EOR projects. The same major participant oil companies, including Kinder Morgan, typically own interests in CO_2 producing units, in the pipelines that transport CO_2 to EOR projects, and the EOR projects themselves. A large percentage of the CO_2 produced by Kinder Morgan at the Unit is injected in its own EOR projects in the Permian Basin; that is, it is used "in-kind" or exchanged with other

EOR operators, not sold or purchased. There is no active market for the CO_2.

The Relevant Provisions of the FSA.

Kinder Morgan's predecessor (Shell) and the other defendants paid over $47 million to settle the claims of the Royalty Owners in *Feerer*. The FSA set out the parties' agreement on the proper method for calculating future royalty payments Kinder Morgan would make to the Royalty Owners.

Kinder Morgan is obligated to pay royalty on "Unit CO_2", a defined term under the FSA that means carbon dioxide produced from the Unit, compressed and delivered into a pipeline. The approved royalty payment methodology is set out in Section 14 of the FSA. It requires Kinder Morgan to "utilize the royalty settlement methodology and the identified benchmarks set forth in subparagraphs (a), (b) and (c) below for the purpose of calculating and paying royalty . . . ". Pet. App. 98.

Section 14(a) requires Kinder Morgan to pay royalty on all of its allocated volumes of CO_2 pursuant to the Unit Agreement or other applicable contracts. *Id.* Section 14(b) requires Kinder Morgan to pay royalty "on the basis of the volume weighted average of the prices for [its] respective sales or other dispositions of Unit CO_2 that [it] separately dispose[s] of or take[s] in kind." Pet. App. 98-99. In other words, Kinder Morgan cannot use prices from sales or dispositions

established by other Unit royalty payors in calculating royalties.

Section 14(c) is the critical provision for purposes of the claims in this case. It provides that Kinder Morgan will pay its Royalty Owners for Unit CO_2 volumes specified in 14(a), "on the basis of the volume weighted average of their respective prices for Unit CO_2 as provided in 14(b), utilizing a net-back methodology . . . **utilizing the prices or values established in their respective Qualified Contracts** . . . that apply to the volumes of Unit CO_2 sold or delivered under such Contracts." (Emphasis added). Pet. App. 99-100. The only approved methodology in this section involves volume weighted average prices under Qualified Contracts, which are listed in Exhibit D-1 to the FSA. *Id.* No other royalty payment methodology is approved by the FSA. The FSA does not approve the use of prices for sales or dispositions established by other benchmarks or Non-Qualified Contracts. *Id.* The volume weighted average price derived from Qualified Contracts is approved as a method for valuing **all** (including in-kind volumes) of Kinder Morgan's Unit CO_2 and paying royalties to the Royalty Owners. *Id.*

The parties to the FSA recognized that there may come a time when there were no Qualified Contracts, or that other benchmarks might be used to calculate future royalties. They agreed that "Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or

approved . . . are improper." Pet. App. 100. Instead, the parties agreed "to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper." *Id.*

The FSA did not pre-approve Kinder Morgan's use of other benchmarks or Non-Qualified Contracts to determine royalty settlement values. The FSA provides that if other benchmarks and/or Non-Qualified Contracts are used, they must be "proper." *Id.*

In addition to the use of agreed Qualified Contracts, the parties to the FSA used two separate and distinct terms to identify other possible sources of prices or values: benchmarks and Non-Qualified Contracts. "Benchmarks" is not a defined term in the FSA. This is the term used by the parties in Section 14(c) to identify other sources of prices or values. Pet. App. 100. "Non-Qualified Contracts" are defined in Section 14(g) as "all contracts for the sale, exchange or other disposition of CO_2" entered into by Kinder Morgan after the date of the FSA or which are not listed on Exhibit D-3. *Id.* Section 14(j) provides that with respect to Non-Qualified Contracts "nothing herein shall be construed to affect or supplant any legal or contractual duties that may be owed" to the Royalty Owners by Kinder Morgan in entering contracts for the sale or other disposition of Unit CO_2. Pet. App. 101. The Royalty Owners retained all rights to claim that Non-Qualified Contracts or Non-Qualified Other Transportation Charges relied upon in establishing

royalty settlement values are "improper for any reason." Pet. App. 102.

Section 16 contains the arbitration provision that is the focus of this appeal. The section begins with a narrow arbitration provision that identifies the only claims subject to arbitration are claims regarding the price or value under Non-Qualified Contracts and Non-Qualified Other Transportation Charges. Pet. App. 102-103. The section does not reference claims related to the use of other benchmarks, or claims based on the failure to calculate the royalty pursuant to 14(a)-(c). *Id.* Arbitration is triggered upon notice by one party to the other of a demand for arbitration which sets forth the matter or matters to be submitted and the name of an arbitrator. *Id.*

More importantly, Section 16 concludes with the general exclusion from arbitration for claims for breach of the FSA. The exclusion utilizes the mandatory "shall," and emphasizes the exclusion by qualifying it with the phrase "in no event." In so doing, the parties confirmed their agreement that no claim for breach of the FSA would be subject to arbitration, and that the general exclusion would control in the event of a conflict with the narrow arbitration provision.

Section 55 of the FSA is not included in Kinder Morgan's Appendix. It provides that "No modification or waiver of, addition to, or deletion from the terms of this Agreement shall be effective unless and until reduced to writing and signed by all of the Parties." Any modification that reduces or impairs any benefit

to the Royalty Owners "shall require approval by the Court."

Misstatements in the Petition.

Throughout the proceedings below and here Kinder Morgan relies on misstatements of fact to support its arbitration demand. First, Kinder Morgan contends that it pays royalties to the Royalty Owners on the proper value of the carbon dioxide at the unit. Petition, p. 6. Whether Kinder Morgan has properly paid royalties on the value of carbon dioxide at the Unit has not been adjudicated. The Court of Appeals did not address the merits of the claim. Pet. App. 8.

Kinder Morgan rewrites the approved royalty payment methodology to authorize the use of **all sales prices** obtained in all sales and other dispositions of carbon dioxide to pay royalties. Petition, p. 6. In fact, Section 14(c) of the FSA does not authorize the use of "all sales prices" in calculating royalties. It expressly approves only the use of "prices or values established in their respective Qualified Contracts." Pet. App. 99. The only approved methodology in the FSA for valuing all Kinder Morgan's production is the use of a volume weighted average price based upon prices or values established in Qualified Contracts, Pet. App. 98-102. There has been no determination in this case that Kinder Morgan is authorized to utilize unapproved sales prices to calculate royalties, and no determination as to whether the prices or values utilized by Kinder Morgan are proper.

Next, Kinder Morgan argues that Section 14(c) gives it the right to use 'other benchmarks' in the weighted average net-back price calculation. Petition, p. 11. Again, this contention is refuted by reading the FSA. Nowhere in Section 14(c) is there any express authorization for Kinder Morgan to use anything other than prices or values established in Qualified Contracts, i.e., approved prices. Pet. App. 98-102. The FSA reserves judgment as to whether "other benchmarks that may be utilized" are proper or improper. Pet. App. 102. The agreement requires that any modification of the terms be in writing and signed by the parties, and that the Court approve any modification that reduces or impairs any benefit of the Royalty Owners.

The fact that the parties "omit any agreement concerning" other benchmarks that might be used to calculate royalties at some time after the FSA was executed does not constitute an agreement that Kinder Morgan has the right to unilaterally modify the royalty payment methodology in Section 14(c). Kinder Morgan would misread an expression of non-agreement as constituting an agreement.

Kinder Morgan must pay lip service to the Section 16 exclusion for breach of contracts claims, so it argues that the exclusionary clause is limited to certain prohibitions contained in other provisions of the FSA, such as Sections 9.2, 10, 11.2, 11.4 and 12. Petition, p. 8. This theory is not supported by the language of Section 16. To the contrary, the exclusion for claims for "breach of this Agreement" is broad and not subject to any restriction. Pet. App. 103. It was

inserted in the FSA to prevent the conduct engaged in by Kinder Morgan, i.e., the unilateral use of unapproved pricing methods without disclosure to the other parties to a multi-lateral agreement.

Kinder Morgan would have this Court believe that there is no definitive CO_2 valuation method set forth in the FSA. Kinder Morgan's position is that once the federal court approved the FSA on April 1, 1998, it could begin valuing the Unit CO_2 using contracts unknown to and not approved by the Royalty Owners. The Royalty Owners could challenge Kinder Morgan's unilateral departure from the approved methodology only if they discovered Kinder Morgan's internal accounting practices so they then could make an arbitration "demand [that] shall set forth the matter or matters to be submitted . . . ". Pet. App. 103.

THE COURT OF APPEALS OPINION

The opinion at issue here is the opinion of the New Mexico Court of Appeals dated August 8, 2006. That opinion recognized the presumption in favor of arbitration, acknowledged and applied the test that "an order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute," and recognized that this rule is "particularly applicable" where a broad arbitration

clause is involved. Pet. App. 8. The Court concluded that in light of the unambiguous exclusion clause of Section 16, the parties to the FSA excluded from arbitration claims for breach of the FSA. Pet. App. 10-14.

Kinder Morgan supports its Petition by misstating the holding of the Court of Appeals in two respects. First, Kinder Morgan contends that the Court of Appeals ignored the presumption favoring arbitration, and held the presumption does not apply in a case involving a narrow arbitration agreement. That is not true. The Court of Appeals noted that both the FAA and the New Mexico Uniform Arbitration Act express a strong presumption in favor of arbitrability. Pet. App. 8. In addressing Kinder Morgan's reliance on the Section 16 arbitration provision, the Court of Appeals noted that "Because the clause is narrow, our usual presumption in favor of arbitration will not resolve the issue." Pet. App. 15. The Court ultimately concluded that "the presumption does not operate to create a right to arbitrate claims the parties have not agreed to arbitrate," citing this Court's *AT & T* decision, 475 U.S. at 648-49 (1986). The Court expressly recognized the rule that an order to arbitrate a particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute, and noted that this provision is "particularly applicable" when the arbitration clause at issue is broad. *Id.* Pet. App. 8-9.

Next, Kinder Morgan contends that the Court of Appeals abandoned its duty to determine arbitrability

based upon a "lack of clarity" in the complaint. Again, this contention is at odds with the opinion itself. In analyzing the arbitrability issue, the New Mexico Court of Appeals distinguished the claims in the complaint. As to the contract-based claims for breach of contract, breach of the covenant of good faith and fair dealing, and breach of the implied duty to market, the Court of Appeals found no lack of clarity: "Claims for breach of contract are necessarily claims for breach of the settlement agreement, because that agreement is the only contract between the parties." Pet. App. 10. The Court examined the facts alleged to determine whether this claim is actually for breach of the settlement agreement, and concluded "that it is." Pet. App. 12. The Court of Appeals further found that the claim of breach of good faith and fair dealing sounds in contract, and consequently found that the claim "is not subject to arbitration." Pet. App. 13. Finally, with respect to the claim for breach of an implied covenant to market, the Court again found that "plaintiffs thus allege breach of the settlement agreement in their fourth claim." *Id.*

The references in the Court of Appeals opinion to a "lack of clarity" in the complaint involved only the non-contract based claims for violation of the New Mexico Uniform Practices Act, constructive fraud, unjust enrichment, and the request for an accounting. The allegations supporting those claims were necessarily general, not out of an attempt at "artful pleading," but because the Royalty Owners did not know how Kinder Morgan calculated royalties at the time

the complaint was filed. The Court of Appeals dealt with that issue properly. The Court denied Kinder Morgan's Motion to Compel Arbitration, but nevertheless held that if, as the case proceeds, it becomes clear that "prices of non-qualified contracts or transportation charges are at issue with respect to the Uniform Practices Act, fraud, and/or unjust enrichment claims," the district court should order arbitration of those claims. Pet. App. 18-19. That ruling has nothing to do with the claims for breach of contract, breach of the duty of good faith and fair dealing, or breach of the implied duty to market.

In any event, that portion of the Court of Appeals decision is a non-issue. Kinder Morgan has agreed to a Class Certification Order which approves class certification only for the claims for breach of contract, breach of the duty of good faith and fair dealing and breach of the implied duty to market. Resp. App. 57-63. Those are the only claims which Royalty Owners will prosecute in this class action lawsuit.

REASONS FOR DENYING THE PETITION

I. The Decision Below Gave Proper Legal Effect To The Parties' Agreement That Claims For Breach Of Contract Are Not Subject To Arbitration.

A. Kinder Morgan Agreed That Claims For Breach Of The FSA Are Not Arbitrable.

The Royalty Owners have a constitutional right to have their claims for damages determined by a jury unless they have contractually agreed to arbitrate the claims. N.M. Const. Art. 2, §12. The issue for the Court to decide is whether the parties agreed to arbitrate the matters under dispute in the Class Action Complaint. *Volt Information Sciences, Inc. v. Board of Trustees,* 489 U.S. 468, 474-5 (1989). The FAA does not require parties to arbitrate when they have not agreed to do so. An agreement to exclude from arbitration "any future claims for breach of this Agreement" is a clear expression of intent to exclude those claims from arbitration. The Court of Appeals correctly applied the exclusion.

The initial inquiry requires the Court to determine whether the parties agreed to arbitrate the dispute. The FAA allows parties to exclude certain claims from the scope of their arbitration agreement, and requires that the court give effect to provisions excluding disputes from arbitration. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 626 (1985). An arbitration provision cannot

be extended beyond the parties' intent. *Volt, supra,* 489 U.S. at 478; *AT & T Technologies, supra,* 475 U.S. at 648-49 (party cannot be required to submit to arbitration any dispute he has not agreed to submit); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395, 404 n.12 (1967) (purpose of FAA "was to make arbitration agreements as enforceable as other contracts, *but not more so*").

The analysis of an arbitration provision is the same as that for construction of any contract. *Mitsubishi Motors, supra* at 626. A court will not rewrite a contract for the parties but should apply the plain meaning of the contract language. A court should adopt a construction that gives effect to all contract provisions, *Smith v. Tinley,* 100 N.M. 663, 664, 674 P.2d 1123, 1124 (1984), and should not adopt a construction that renders some contract provisions superfluous. *Bank of New Mexico v. Sholer,* 102 N.M. 78, 79, 691 P.2d 465, 466 (1984). The Court of Appeals correctly held that whether a claim falls within the scope of an arbitration agreement turns on the factual allegations in the complaint. *Gregory v. Electro-Mechanical Corp.*, 83 F.3d 382, 384 (11th Cir. 1996); *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d 861, 871 (10th Cir. 1999).

The Royalty Owners assert as their primary claim for relief a claim for breach of the FSA based on Kinder Morgan's failure to properly pay royalties as required by the formula provided in Section 14. Section 16 of the FSA expressly excludes claims for

breach of contract from the scope of the narrow arbitration provision. Pet. App. 103. The Court of Appeals correctly applied the broad exclusion, which is fatal to Kinder Morgan's appeal with respect to the Royalty Owners' claims for breach of the FSA, breach of the covenant of good faith and fair dealing, and breach of the covenant to market.

Kinder Morgan contends that the Court of Appeals simply accepted the Royalty Owners' characterization of their claims as contract-based in resolving the arbitration issue. Petition, pp. 23-26. There is no dispute in this case that the Royalty Owners have asserted claims for breach of contract, breach of the duty of good faith and fair dealing, and breach of the implied duty to market. The Court of Appeals independently analyzed these claims and correctly determined that they were contract claims, and therefore fell within the exclusion. Pet. App. 12-13.

B. A Presumption In Favor Of Arbitration Does Not Trump The Express Exclusion Of Section 16.

Kinder Morgan contends that the Court of Appeals held that "the presumption favoring arbitration does not apply in a case involving a narrow arbitration agreement or when there is an exclusionary clause in an arbitration agreement." That is simply not true. The Court of Appeals noted that both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act "express a strong presumption in

favor of arbitrability." Pet. App. 8. The Court of Appeals recognized the presumption but correctly concluded that "The presumption does not operate to create a right to arbitrate claims the parties have not agreed to arbitrate," citing this Court's *AT & T* decision. Pet. App. 8-9.

Kinder Morgan's repeated mantra of the presumption in favor of arbitration does not change the language of Section 16 of the FSA. It does not change the fact that the parties excluded from arbitration claims for breach of the FSA using the mandatory "shall" term and providing further emphasis on the exclusion by providing that "in no event" would future claims for breach be subject to the FSA. The federal presumption in favor of arbitration does not change the fact that the parties agreed upon a narrow arbitration clause that applies only to claims regarding prices or values under Non-Qualified Contracts. It does not change the fact that the Royalty Owners did not reference Non-Qualified Contracts in their complaint. The policy favoring arbitration cannot extend the application of an arbitration clause beyond its intended scope. *McDonnell Douglas Fin. Corp. v. Pennsylvania Power & Light Co.*, 858 F.2d 825, 831 (2d Cir. 1988).

C. Kinder Morgan's Misconstruction Of The FSA Was Considered And Rejected Below.

Kinder Morgan raises several complaints designed to give the false impression that the Court of Appeals did not properly consider its position below. There is no basis for these complaints.

First, Kinder Morgan contends that the Court of Appeals did not consider its narrow interpretation of the FSA provision excluding from arbitration claims for breach of the FSA. Petition, p. 25. Again, this statement is simply not supported by a reading of the opinion below. The Court of Appeals considered but correctly recognized that Kinder Morgan's interpretation made no sense: "Its interpretation of the arbitration agreement would leave essentially no viable claims that would not be subject to arbitration, despite the fact that the arbitration clause is narrow and explicitly excludes claims for breach of the settlement agreement." Pet. App. 6.

The Court of Appeals was correct. Under Kinder Morgan's theory, breach of affirmative provisions such as the key terms of Section 14(a)-(c) would not constitute a breach of the agreement. There is no support in the record for this argument, which is contrary to the express language of the exclusion for "any future claims for breach of this Agreement." The parties to the FSA could have excluded from arbitration only breaches of Sections 9-11 of the FSA, but did not do so.

Next, Kinder Morgan argues that Court of Appeals blindly adopted the Royalty Owners' construction of Section 16 so as to negate the arbitration provision such that claims regarding price or value under Non-Qualified Contracts would be excluded from arbitration. Petition, pp. 18-20. The argument hinges on Kinder Morgan's erroneous contention that the FSA gives it the right to use unapproved prices or values without disclosure to or approval from the Royalty Owners. This theory is both wrong and illogical, and the Court of Appeals properly rejected it.

The FSA recognizes a procedure under which the narrow arbitration provision in Section 16 would operate. If Kinder Morgan wished to modify the parties' agreed methodology, it would disclose to the Royalty Owners that it wished to use one or more other benchmarks or Non-Qualified Contracts, and provide the terms of those contracts and any new or other benchmarks to the Royalty Owners for review. The Royalty Owners would then have an opportunity to agree to the use of the prices or values under Non-Qualified Contracts, or to object. If the parties could not agree on the use of prices or values under Non-Qualified Contracts, then either party could invoke Section 16 by serving a demand that "sets forth the matter or matters to be submitted and the name of the arbitrator." Pet. App. 102-03.

In fact, it is Kinder Morgan's construction of the FSA that seeks to render significant portions of the FSA. Kinder Morgan would have this Court adopt a

construction of the FSA that would permit Kinder Morgan to depart from the methodology approving valuation based on the volume weighted average prices of Qualified Contracts and use undisclosed prices and values that had never been approved by the Royalty Owners. This is the very scenario the FSA was intended to prevent. Kinder Morgan's interpretation would allow it to unilaterally reduce the benefits to which Royalty Owners are entitled without Court Approval in violation of Section 55 of the FSA.

D. The Court Of Appeals Applied The Proper Test To Determine Arbitrability.

Even if the Court were to ignore basic rules of contract construction and the exclusionary language of Section 16, the Royalty Owners' claims would not be subject to arbitration. The Court must compare the allegations of the Complaint to the arbitration provision the parties adopted to determine if the claims are subject to arbitration. The only claims subject to arbitration are claims involving prices or values under Non-Qualified Contracts or Non-Qualified Other Transportation Charges. There is no such claim in the Class Action Complaint. Pet. App. 27-44.

The Court of Appeals reached the correct conclusion below because the Section 16 arbitration provision is indeed narrow. It does not contain a general arbitration provision under which the parties agreed to arbitrate all disputes arising from the FSA. See

McDonnell Douglas, supra, 858 F.2d at 831. As the Court of Appeals properly recognized, the fact that the arbitration provision in Section 16 is narrow has ramifications for its interpretation and application. When a narrow arbitration provision is involved, arbitration will not be compelled where the dispute is one the parties excluded from arbitration. *New York News, Inc. v. Newspaper Guild of New York*, 927 F.2d 82, 83-4 (2d Cir. 1991); *Chevron USA Inc. v. Consolidated Edison Co. of N.Y.*, 872 F.2d 534, 538 (2d Cir. 1989) (although a narrow arbitration clause must be construed in light of the presumption favoring arbitration, "the court is not free to disregard the explicit boundaries set by the agreement between the parties").

The complaint does not mention Non-Qualified Contracts or Non-Qualified Other Transportation Charges. Pet. App. 27-44. The most Kinder Morgan can argue is that the Royalty Owners challenge the result of the net-back pricing methodology Kinder Morgan utilized. But that only implicates the failure of Kinder Morgan to adhere to Section 14 and subsections (a), (b) and (c) of the FSA – a breach of contract and related implied covenants.

The possibility of a dispute arising over royalty calculation and payments was foreseeable when the FSA was negotiated and executed in 1998. The parties did not agree to a broad arbitration provision to cover any such dispute. The fact that they did not, and expressly excluded future claims for breach of the FSA, compels the conclusion that the Royalty Owners'

claims are not subject to arbitration. *McDonnell Douglas, supra,* 858 F.2d at 832 (narrow arbitration clause must be carefully applied to carry out limited intent of parties).

E. Disputes Over Prices For Unit Co_2 Do Not Necessarily Implicate Non-Qualified Contracts.

Kinder Morgan argues that the Royalty Owners' claims must involve disputes regarding the price or value under Non-Qualified Contracts because prices or values under Qualified Contracts are not open to dispute. This contention misses the point. It also ignores the true nature of the Royalty Owners' breach of contract claims based on Kinder Morgan's failure to follow the Section 14 methodology for calculating royalty. The test for arbitrability is based upon the actual allegations of the Complaint, not Kinder Morgan's characterization of what the claims must "of necessity" be "predicated upon."

Even if the Court were inclined to look behind the allegations of the complaint, it is obvious that there are a variety of circumstances which would involve claims for royalty underpayment unrelated to prices or values under Non-Qualified Contracts. Kinder Morgan may use its very low CO_2 prices based simply on how it designs its expense economics for its EOR business. Examples in the record include Kinder Morgan deducting a transportation charge in excess of that authorized by the FSA, and failing to use

correct values under Qualified Contracts. Resp. App. 13-14.

Moreover, if Kinder Morgan used other benchmarks, such as pricing Unit CO_2 based on its EOR budget, or on its cost of production, etc., claims for underpayment based on that conduct would not involve Non-Qualified Contracts. Even if Non-Qualified Contracts were in place, the evidence may demonstrate that those contracts were not arms-length contracts, or were illusory or sham agreements designed to provide cover for a price Kinder Morgan unilaterally set for royalty purposes, or that a contract sets a "price" but no volumes of Unit CO_2 were really sold under the contract.

Kinder Morgan unilaterally divides the universe of prices or values that might be used in determining royalty settlement values into two categories: Qualified Contract prices and Non-Qualified Contract prices. The FSA does not support this dichotomy. The FSA recognizes three potential sources of prices or values: Qualified Contracts, Non-Qualified Contracts, and other benchmarks. Pet. App. 98-102. The terms "other benchmarks" and "Non-Qualified Contracts" are not synonymous, and the parties to the FSA recognized a distinction between the terms. Disputes regarding other benchmarks that are not prices or values under Non-Qualified Contracts are not subject to arbitration. Prices or values not based on Qualified Contracts are not by default prices or values under Non-Qualified Contracts.

The Court of Appeals did include in its opinion statements to the effect that the Royalty Owners claimed that the use of Non-Qualified Contracts constitutes a breach of the FSA. Pet. App. 4, 5, 12. The Royalty Owners cannot explain why the Court of Appeals included those statements, because they do not represent the breach of contract theory at issue in this case. The Court of Appeals near the end of the opinion seems to contradict these earlier statements by concluding that "it is inappropriate to compel arbitration when Plaintiffs may not dispute the prices under non-qualified contracts at all." Pet. App. 18. In any event, these statements in the opinion below do not affect the arbitrability analysis or compel a different result. The parties to the FSA expressly provided that the exclusion for claims for breach of the FSA would control in the event of a conflict between the exclusion and the narrow arbitration provision.

II. There Is No Split Between Lower Courts For This Court To Resolve.

Because a court's first inquiry in a dispute as to arbitrability of certain claims is to determine the intent of the parties based upon the language of the agreement, all courts necessarily examine the scope of an arbitration provision. All courts recognize a distinction between narrow and broad arbitration clauses. All courts employ a similar analysis in determining these issues. Some jurisdictions have expressly stated a rule that the presumption favoring arbitration is less applicable to a narrow arbitration

clause than to a broad arbitration clause. These jurisdictions are cited in the Petition at pp. 15-16, fn. 10-15. This distinction traces back to this Court's *AT & T* decision, which expressly recognized that the presumption of arbitrability is particularly applicable with respect to broad arbitration clauses. 475 U.S. at 650.

While the New Mexico Court of Appeals cited to some of these cases and noted that the arbitration clause at issue was narrow, it did not hold that the presumption favoring arbitration was inapplicable. Pet. App. 8-10. Instead, as to the contract claims, the Court of Appeals held that claims for breach of the settlement agreement are "not subject to arbitration" under the unambiguous language in Section 16. Pet. App. 13. This result is consistent with the rule announced by this court that where the parties have clearly expressed their intent to exclude certain claims from the scope of arbitration, those exclusions are effective. *Mitsubishi Motors, supra.*

Kinder Morgan points out that while some jurisdictions appear to require that a claim must "on its face" fall within the preview of a narrow arbitration clause in order to support a motion to compel arbitration, other jurisdictions draw no distinction between narrow and broad arbitration clauses in applying the presumption in favor of arbitration.[4] Petition,

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[4] Kinder Morgan cites the Fifth Circuit as a circuit that does not distinguish between broad and narrow arbitration

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pp. 18-22. A review of those decisions indicates that the differences in language are semantic differences that do not affect the substantive analysis all courts apply to arbitration questions based on the rules announced in the decisions of this Court.

While the New Mexico Court of Appeals cited numerous cases, including cases from the Tenth Circuit Court of Appeals, that recognized the distinction between broad and narrow arbitration clauses, the Court below did not base its ruling on the restrictive test Kinder Morgan emphasizes in its Petition. Instead, the New Mexico Court of Appeals based its ruling on the unambiguous exclusion from arbitration in the FSA that provides that the "provision concerning arbitration . . . shall, in no event, apply to any future claims for breach of this Agreement."

The Court's decision below represents a reasoned and correct application of the rules for determining arbitrability. The favorable construction rules are limited when the court is reviewing a narrow, rather than a broad arbitration provision. *Cummings v. Fed Ex Ground Package System, Inc.*, 404 F.3d 1258 (10th Cir. 2005); *McDonnell Douglas, supra,* 858 F.2d at 832; *Simon v. Pfizer, Inc.*, 398 F.3d 765, 775 (6th Cir. 2005). When an arbitration clause extends only to a specific type of dispute, a court cannot require

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provisions. However, the Fifth Circuit does recognize the distinction. *Complaint of Hornbeck Offshore (1984) Corp. v. Coastal Carriers Corp.*, 981 F.2d 752, 754-55 (5th Cir. 1993).

arbitration of claims that are not included because arbitration is a matter of contract. *Id.* Application of these universal rules does not subvert the FAA in any way. Any other result would allow the presumption in favor of arbitration to rewrite the parties' agreement.

Kinder Morgan also claims that the New Mexico Court of Appeals decision conflicts with law in the Fourth Circuit Court of Appeals, citing *Choice Hotels Intern., Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707, 700 (4th Cir. 2001). That is wrong because *Choice Hotels* involved a broad arbitration provision that provided for arbitration of "any controversy or claim relating to this Agreement, or the breach of this Agreement" subject to three exceptions. 252 F.3d at 710.

The question in *Choice Hotels* involved whether the dispute involved an action for collection of moneys owed under the agreement, an exception to the broad arbitration provision. The Court held that the claim for breach of the franchise agreement was not a collection action under the exception to the broad arbitration provision, thus was subject to arbitration. 252 F.3d at 711. The Court also held that the claim to collect the affiliation fee was a collection action not subject to arbitration. *Id.* at 712. There is no conflict between the two decisions. Even if there were a dispute between the New Mexico Court of Appeals decision and a decision from the Fourth Circuit Court of Appeals, that is a conflict that this Court need not resolve. New Mexico courts are not bound by Fourth Circuit precedent.

III. Royalty Owners Have Not Utilized "Artful Pleading" To Avoid The Narrow Scope Of The Section 16 Arbitration Provision.

Kinder Morgan contends that the Court of Appeals fell victim to "artful pleading" by the Royalty Owners in an effort to hide the true nature of their claims in this case to escape the narrow arbitration provision. There is no support in this record for this contention. This has always been a case of breach of the FSA. Kinder Morgan never explains why the Royalty Owners would initially serve a complaint in arbitration, then withdraw it after the Unit Operator complained that the claims were covered by the Section 16 exclusion, and refile the same substantive claims in this lawsuit, if the Royalty Owners were attempting to avoid arbitration by artful pleading.

The claim that Kinder Morgan failed to pay royalties based on the FSA formula in Section 14(c) is a claim for breach of contract that is expressly excluded from arbitration in Section 16. Consequently, Kinder Morgan cannot rely on the complaint to support arbitration. Kinder Morgan fixates on the Royalty Owners' statements in a motion to compel discovery. Petition, p. 10. The Royalty Owners filed a motion to compel because Kinder Morgan refused to produce relevant documents in response to discovery requests. When the Royalty Owners filed their motion, they had none of the underlying contracts Kinder Morgan represented it used to calculate royalties. They did not know precisely how Kinder Morgan calculated royalties. They had only Kinder

Morgan's representations about the methodology provided in support of its motion to compel arbitration. However, even in this pleading, the Royalty Owners confirmed that "The primary thrust of the complaint is that Kinder Morgan has breached the Feerer Settlement Agreement in the manner and method by which it fails to honor its royalty obligations." Pet. App. 73-74.

CONCLUSION

The Court of Appeals decision in this case gave effect, as it must, to the agreement between the parties that claims for breach of the FSA would not be subject to arbitration. The reams of paper used in addressing this issue cannot change the language of Section 16. The federal policy in favor of arbitration does not modify or override the parties' agreement that claims for breach of the FSA are not subject to arbitration.

The Courts are fond of touting arbitration as an economical and efficient means of dispute resolution. Here, Kinder Morgan has turned a narrow arbitration provision into a vehicle to litigate its motion to compel arbitration in the New Mexico district court, the Court of Appeals, the New Mexico Supreme Court, and now this Court. Merits discovery and substantive resolution of the claims have been derailed for over three years. The Royalty Owners

respectfully request that this Court deny Kinder Morgan's Petition.

Respectfully submitted,

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STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant.

No. 04-26 CV

(Filed Feb. 23, 2005)

PLAINTIFFS' SUPPLEMENTAL BRIEF IN OPPOSITION TO DEFENDANT'S MOTION TO COMPEL ARBITRATION

The plaintiffs submit this supplemental brief in opposition to the defendant's Motion to Compel Arbitration and Stay Proceedings.

I. INTRODUCTION

When the plaintiffs filed a demand for arbitration on July 26, 2004, withdrew that demand, and on August 3, 2004[1] filed and served their complaint herein, they knew nothing about how Kinder-Morgan was calculating royalty payments to the plaintiffs. The extent of plaintiffs' knowledge was that since 2000 there was and continues to be a remarkable and increasing disconnect between the Bravo Dome CO2 values and the historically high and increasing price of Permian Basin crude oil.

Kinder-Morgan filed the subject motion on September 28, 2004 attaching documents identified as Exhibits 1 through 12. Exhibit 11 was the Affidavit of Dr. Stephen Becker who had the benefit of access to the defendant's records and contracts and offered the opinion that the plaintiffs' claims raised a claim against Non-Qualified Contracts and Non-Qualified Other Transportation charges covered by the Settlement Agreement Section 16 arbitration provision.[2]

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[1] Two days after July 26, 2004, plaintiffs were served with the Oxy USA Complaint for Declaratory Judgment in Chaves County alleging that plaintiffs' claim is for breach of the Feerer Settlement Agreement "a claim specifically excluded from arbitration by the last sentence of the arbitration provision." Oxy Complt.¶ 11.

[2] In fashioning the Settlement Agreement the parties made lists of existing contracts for the sale or other disposition of Unit CO2 that were approved for use by the lessees. Those contracts were called "Qualified Contracts." In the case of Kinder-Morgan (f/k/a Shell) the approved contracts are listed on Exhibit D-3 to

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The plaintiffs responded on October 18, 2004 stating their opposition to the motion and that "Discovery is necessary to allow the class to determine exactly how the royalties are calculated and to identify all the issues which the class contends constitute breaches of the Settlement Agreement contributing to the underpayment of royalties." Plaintiffs' Response 15.

Limited discovery began with production by defendant of some CO2 sales contracts in mid-November 2004. Other contracts were produced in December and requested additional documents were provided as recently as last week, on February 18, 2005. The deposition of defendant's witness Dr. Stephen Becker was taken in Austin, Texas on Friday, February 18, 2005.[3] Now that plaintiffs have had an opportunity to tediously examine the evidence from Kinder-Morgan, and now that those documents and Kinder-Morgan's affidavits and exhibits have been reviewed by plaintiffs' expert witness, George Donkin, there are important determinative points and analysis to be considered by the Court on the Motion to Compel Arbitration. A copy of Mr. Donkin's Affidavit,

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the Settlement Agreement. All contracts entered into by Kinder-Morgan after the date of the Agreement are called "Non-Qualified Contracts."

[3] This document production by Kinder-Morgan has only been partial with respect to the range of documents requested by plaintiffs in September, 2004. Plaintiffs have filed a Motion to Compel additional documents, which motion was filed on December 10, 2004. That motion is also scheduled to be heard on February 24, 2005.

offered in opposition to the Motion to Compel Arbitration, is attached hereto as Exhibit A. The Stephen Becker Affidavit is attached as Exhibit B-1 and referenced portions of the Stephen Becker deposition are attached as Exhibit B-2. Attachment Exhibit C is a copy of Exhibit 8 to Stephen Becker's deposition listing the contracts used by Kinder-Morgan to calculate the subject royalties categorized as either Qualified or Non-Qualified.

II. THE AGREED CO2 PRICE BENCHMARKS – SECTION 14(a), (b) AND (c)

The prior federal court class action litigation by the Bravo Dome private royalty and override owners against Amoco Production Company, Amerada Hess, Shell and Exxon was concluded by the Settlement Agreement filed with the federal court on April 1, 1998. Exhibit "A" to the Complaint. The plaintiffs and the class received two forms of consideration under that Agreement. One was cash payments totaling about $47,500,000. The other was a specified methodology to be used by the Bravo Dome working interest owners in the calculation of future royalty payments beginning January 1, 1998.

As relevant to this case, the approved ongoing payment method[4] specified in Section 11 of the

[4] The Settlement Agreement prohibits the reduction of royalty for the expense of Unit gathering, dehydration and compression. That is not believed to be an issue here.

Settlement Agreement set a limit on deduction from royalty for certain services in transporting the compressed CO2 from the Bravo Dome to the enhanced oil recovery (EOR) fields. Section 12 mandates that the price under a certain "1994 Contract" between Amoco and Amerada Hess "shall not be used by Defendants as a benchmark for calculating royalties . . . ", Section 13 specifies that while a company can use the weighted average price of CO2 volumes it sells or takes in-kind it cannot factor in the prices and volumes of other Unit working interest owners, i.e., it precludes use of a "Unit" weighted average price.

Finally, and most importantly,. Section 14 of the Agreement sets-out the approved CO2 pricing methodology. The previously noted sections of the Settlement Agreement each state prohibitions on royalty calculation by the working interest owners. Conversely, Section 14 (pages 22-25 of the Agreement, attached as Exhibit D) states a positive, to wit: The working interest owners "**will utilize** the royalty settlement methodology and the identified **benchmarks**[5] **set forth in paragraphs (a), (b) and (c)** below for the purpose of calculating and paying royalty to the Respective Owners, **which methodology, benchmarks and resulting payments are hereby agreed to and approved** by Amoco's, Hess'

[5] "bench marks" – a standard in measuring. *Webster's New World Dictionary,* (3d Ed.).

and Shell's Respective Owners [royalty payees]." Emphasis added. The approved benchmarks are:

(a) The subject is Bravo Dome CO2 volumes;

(b) The companies will use weighted average prices "for their respective sales or other dispositions of Unit CO2 . . .

(c) Kinder-Morgan and the other companies will use the "prices or values established in **their respective Qualified Contracts** . . . their respective transportation charges established as **Qualified Other Transportation Charges** . . . and their respective **Approved Mainline Deductions** . . . " Emphasis added.

The approved and agreed benchmarks **do not** include CO2 prices under Non-Qualified Contracts nor the use of Non-Qualified Transportation Charges. That is to say, what was approved, logically enough, was use of the known and approved contracts.

Section 14(c) concludes by stating that there is no agreement on whether future benchmarks that may be used in the future for royalty settlement are or are not proper.

III. ARBITRATION PROVISION

The arbitration provision in Section 16 of the Settlement Agreement is narrow. It applies only to "**claims . . . asserted** against . . . [Kinder-Morgan] regarding (a) the price or value under Non-Qualified

Contracts ... Unitilized by ... [Kinder-Morgan] in establishing royalty settlement values ... ". Expressly excluded from the arbitration provision are "**any future claims for breach of this agreement.**"

IV. THE LEGAL STANDARDS

A. The Contract

As a contractual remedy, arbitration clauses are governed by contract law. *Santa Fe Technologies Inc. v. Argus Network Inc.*, 2002-NMCA-030, ¶ 52, 131 N.M. 772, 788, 42 P.3d 1221; *Casias v. Dairyland Ins.*, 1999-NMCA-046, ¶ 11, 126 N.M. 772, 975 P.2d 385. A court will not rewrite a contract for the parties and, in its interpretation, the court will apply the plain meaning of the contract language. *Santa Fe Technologies, supra.*

Whether the parties have agreed to arbitrate is a question of law. *Casias*, 1999-NMCA-046, ¶ 13, 126 N.M. 772; NMSA 1978 § 44-7A-7(b). Therefore, the court's inquiry is whether the parties have agreed to arbitrate the matter under dispute. *Santa Fe Technologies, supra.*[6] The law requires a close connection

[6] The fact that the arbitration provision is very narrow has ramifications for the interpretation and application of that provision. When a narrow arbitration clause is at issue, arbitration will not be compelled unless the dispute falls precisely within the terms of the clause. *New York News, Inc. v. Newspaper Guild of New York*, 927 F.2d 82, 83-4 (2nd Cir. 1991). See also *Chevron USA Inc. v. Consolidated Edison*, 872 F.2d 534 (2nd Cir. 1989) (even though a narrow arbitration clause must

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between the subject matter of the agreement and the subject matter of the dispute. *Santa Fe Technologies*, 131 N.M. 789.

The terms of a contract cannot be changed unilaterally by one party; there must be mutuality. *Heye v. American Golf Corp. Inc.*, 2003-NMCA-138, ¶ 12, 134 N.M. 558, 562, 80 P.3d 495 ("A valid contract *must* possess mutuality *of* obligation"); *Discover Bank v. Shea*, 362 N.J.Super. 200, 827 A.2d 358 (2001) (New Jersey courts do not permit unilateral amendments to existing agreements to change material terms, invalidating Bank's attempt to amend credit card agreement to require arbitration of disputes by sending its customers a "bill stuffer" notifying them of arbitration clause); *Guy Pine, Inc. v. Chrysler Motors Corp.*, 201 Kan. 371, 440 P.2d 595 (1968) (one party to contract cannot unilaterally change the terms, there must be mutuality). The New Mexico Supreme Court characterized a contract that allowed one party, the employer, to unilaterally modify the terms "illusory," and refused to enforce an arbitration provision in the contract. *Salazar v. Citadel Communications Corp.*, 2004-NMSC-013, 135 N.M. 447, 450, 90 P.3d 466:

> Under general New Mexico contract law, an agreement that is subject to unilateral modification or revocation is illusory and unenforceable. *Bd. of Ethic. v. James Hamilton*

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be construed in light of the presumption favoring arbitration, the court is not free to ignore explicit boundaries set by the parties' agreement).

Constr. Co., 119 N.M. 415, 420, 891 P.2d 556, 561 (Ct. App. 1994). This principle applies equally to agreements to arbitrate. *Heye*, 2003-NMCA-138, ¶¶ 11-12, 134 N.M. 558, 80 P.3d 495.

B. The Plaintiffs' Complaint

The critical Section 16 arbitration provision is confined to "Any **claims asserted** by Plaintiffs or members of the Class . . . regarding (a) the price or value under Non-Qualified Contracts . . ." Emphasis added.

Whether a claim falls within the scope of an arbitration agreement turns on the factual allegations in the complaint. *Gregory v. Electro-Mechanical Corp.*, 83 F.3d 382, 384 (11th Cir. 1996); *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d 861, 871 (10th Cir. 1999); *Santa Fe Technologies*, 131 N.M. at 789 ("When we hold SFT's claims up against the Agreement, we do not see overlap").[7]

[7] Kinder-Morgan cites the same rule in its Reply (at 3) on the subject motion, but then ignores the fact that the plaintiffs' factual allegations in the Class Action Complaint allege absolutely nothing concerning Non-Qualified Contracts, or for that matter, Qualified Contracts.

V. EXPERTS' ANALYSIS OF THE AGREEMENT

The definitive interpretation of the language of the Settlement Agreement lies with the Court as a question of law. Each side, however, provides a reading and interpretation by expert consultants. Each expert does so in the context of these undisputed facts:

1. The written words of the Settlement Agreement approve only one mutually agreed source of CO2 values, those based on Qualified Contracts and approved transportation deductions. Section 14(c).

2. For the time period material to this case Kinder-Morgan has used CO2 prices from non-approved, Non-Qualified Contracts mixed with approved contract prices to determine and pay royalty.

3. The changed benchmark of mixing Non-Qualified contract prices with Qualified contract prices was implemented unilaterally by Kinder-Morgan without knowledge, participation or approval by the royalty owners or their representatives.

4. The monthly remittance statements sent by Kinder-Morgan to royalty owners provide no information as to what contract prices are used in royalty calculation. See sample of J. Casper Heimann statements attached as Exhibit E.

Stephen Becker Opinion – Defendant's Witness

Since Section 14(c) does not include Non-Qualified Contracts, defendant's expert Dr. Stephen Becker believes that it "contemplates [CO2 prices are] to result from a mix of both Qualified and Non-Qualified downstream contract prices . . . " The missing wording is thus supplied by opinion as being "contemplated." Becker Affd. ¶ 4, Ex B-1. In his deposition Dr. Becker changed his word selection from "contemplates" to "it is clear to me that 14(c) anticipates that there will be qualified contracts and non-qualified contracts . . . the way they laid it out it clearly anticipates that – the use of things other than qualified contracts." Dep. 51, 52 Ex. B-2 attached. He considers the terms "contemplates" and "anticipates" as synonymous. Dep. 54, *Id.* He concedes, as he must, that the words 'non-qualified contract' do not appear in 14(c), Dep. 54, *Id.*, while the qualified contracts were expressly approved by the express wording of the subparagraph. Dep. 54, Ex. B-2. When a royalty owner, such as Casper Heimann, looks at his check stub there is nothing that would tell him what contracts, qualified or non-qualified, were being used by Kinder-Morgan. Dep. 58, Ex. B-2.

Dr. Becker testified that when non-qualified contracts begin to be used by defendant in the royalty calculation that practice constitutes the use of another "benchmark." "So, yes, it would be a benchmark different from the price, the price or value you'd see under qualified contracts." Dep. 67, 68, Ex. B-2.

Q. So the other benchmark, then, can come into use unilaterally; that is to say, simply by Kinder-Morgan deciding it's going to use some non-qualified contracts, it can initiate another benchmark for calculation of the royalty?

A. Yeah. I mean, I wouldn't characterize it as "initiate another benchmark" because in may kind it leaves a reader with the impression that you've done this whole sale change from when we were doing it this way, and we unilaterally decided to pick up and go value it on this other thing. The use of prices and values obtained under non-qualified contracts is a benchmark different from those that you get from qualified contracts. And I would agree that per the terms of the settlement agreement, I don't see anything that says that Kinder-Morgan has to get permission from anyone to begin using non-qualified contracts, nor do I see anything in here that requires that Kinder-Morgan provide any notice that it's doing so. The settlement agreement anticipates that it's going to be done in my reading of it. But I don't see any approval step called for here.

* * *

Q. Right. In other words, unilaterally that can be done?

A. Yes.

Dep. 68, 69, Ex. B-2.

George Donkin – Plaintiffs' Witness

Mr. Donkin is an experienced natural gas economist who has worked on many prior lawsuits involving claims by royalty owners of underpayment on CO2 produced from the Bravo Dome and the McElmo Dome in southwest Colorado. His affidavit is attachment Exhibit A.

Section 14(c) of the Settlement Agreement shows that the parties agreed "only to the use of known, existing and identified contracts for sale or disposition of CO2 and specifically did not agree to the use of Non-Qualified Contracts in the agreed methodology for calculating settlement royalty values." Aff. Donkin, ¶ 16, Ex. A.

The conclusion of Dr. Becker that royalty values are to result from a mix of qualified and non-qualified contracts is incorrect. As Mr. Donkin puts it: "In my experience, sales agreements in the petroleum industry do not 'contemplate' how things are to be done, i.e, they say what they mean." Aff. Donkin, ¶ 17, Ex. A. He believes it is only logical that the parties to the Settlement Agreement would never agree to have their royalty paid on the basis of unknown future benchmarks "using volumes and prices in unknown future CO2 sales agreements." Aff. Donkin, ¶ 18, Ex. A.

Mr. Donkin concludes that for the period January 2000 to July 2004 Kinder-Morgan has failed to arrive at the royalty value using the methodology called for

by the terms of the Settlement Agreement. In addition to that departure from the contract, upon the limited discovery available, it appears to Mr. Donkin that Kinder-Morgan failed to honor the Settlement Agreement terms in other ways:

a) using mainline transportation deductions in excess of $0.11 per Mcf for CO2 gas to the Seminole San Andres Unit by use of a $0.09 "meter fee" and $0.025 additional tariff;

b) lowering the stated per Mcf price for supplies of CO2 by obtaining non price consideration in the form of a transfer of a buyer's property interest in an EOR project in one contract and in another by obtaining a right to process the natural gas produced from a CO2 buyer's EOR field;

c) and failing to apply the oil formula price plus a minimum price ($0.625) on a certain Qualified Contract so that for years a CO2 value of 57¢ or 58¢ was used for royalty until the price was finally corrected in April 2004 to $1.039 and in July 2004 to $1.15 per Mcf.

VI. CONCLUSION

"A court will not rewrite a contract for the parties and, in its interpretation, the court will apply the plain meaning of the contract language." *Santa Fe Technologies,* 131 N.M. 788. The same must be said for a party's complaint.

In order to try to fit this case into the narrow confines of the Section 16 arbitration provision, Kinder-Morgan seeks by opinion testimony to rewrite Section 14(c) so that the express omission of non-approved contracts might be overcome because their inclusion was supposedly "contemplated." Defendant would have the Court accept that it can use the Non-Qualified Contracts, change the Settlement Agreement's approved pricing benchmarks, and do all of that unilaterally without breaching the Agreement. Breaches of the Agreement, of course, are expressly excluded from the Section 16 arbitration provision.

Even reading into the Settlement Agreement wording that does not exist fails to get the defendant to its desired result. It must also morph the plaintiffs' Complaint and even morph the legal standard by which the Complaint is to be read. According to defendant, the August 3, 2004 Class Action Complaint supposedly states "claims asserted" (Section 16) about prices under non-qualified contracts. The Complaint contains no such allegation. In fact what plaintiffs have alleged concerning royalty payments by Kinder-Morgan during 2000-2004 is fairly summarized, viz:

- Given the direct, functional and economic connection between Unit CO2 and oil and gas produced by its use in EOR projects and the growing demands for CO2 "the values set by the defendant for payment of the subject Royalty Interests

are patently and significantly improper." Complt. ¶ 27.

- "Kinder-Morgan has concealed the improper basis upon which the royalty calculations are made and the actual economic consequences and benefits enjoyed by it which economic benefits are not and have not been shared by Kinder-Morgan with the royalty Interest Owners." Complt. ¶ 30.

"When we hold [plaintiffs'] claims up against the Agreement, we do not see overlap." *Santa Fe Technologies,* 131 N.M. 789. What one does see is that Section 16 by its own terms does not "apply to any future claims for breach of this Agreement," (Section 16) and claims of such breaches are precisely what is alleged by the plaintiffs.

The defendant in its briefing must make yet one more distortion of the written word. In its Reply on this motion defendant first recites the rule, as did plaintiffs above, p.7, that whether a case falls within the scope of an arbitration agreement depends on the factual allegations of the complaint. *Gregory, supra; P&P Industries Inc., supra; Santa Fe Technologies, supra.* The problem for defendant is that the written allegations of the Complaint are of absolutely no help to it. So defendant turns the rule on its head by arguing "What is relevant is the underlying factual basis for the claims." Reply 3. There is no legal support cited by defendant for this contention and none is to be found.

The written terms of the Settlement Agreement, the allegations of the Complaint, and the applicable law all stand against the motion to compel arbitration. The motion must be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused a true and correct copy of the foregoing Plaintiffs' Supplemental Brief in Opposition to Defendant's Motion to Compel Arbitration to be served on this 22nd day of February, 2005, to the following counsel of record:

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VIA FACSIMILE

/s/ J.E. Gallegos
J.E. Gallegos

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs. No. D-818-CV-2004-00026

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant.

AFFIDAVIT OF GEORGE L. DONKIN

STATE OF VIRGINIA)
) ss:
COUNTY OF ARLINGTON)

1. My name is George L. Donkin. I am a Vice President, employed by J.W. Wilson & Associates, Inc., ("JWWA") Rosslyn Plaza C, Suite 1104, 1601 North Kent Street, Arlington, Virginia 22209. I hold B.A. and M.A. degrees in economics from the University of Maryland, where my major fields of study were economic theory, industrial organization, and antitrust economics. I am a consulting economist specializing in energy economics and public policy toward business. I have

nearly thirty-five years of experience as an energy economist, both as a consultant and a staff economist at the Federal Power Commission, the predecessor of the Federal Energy Regulatory Commission ("FERC"). Since 1974, I have been employed as a consulting economist representing various clients, including federal agencies, state regulatory commissions, numerous state consumer advocate offices, public and private utility companies, industrial firms, natural gas producers, gas pipelines, gas marketers, local natural gas distribution companies, and non-profit organizations. My professional work has pertained to a wide range of issues concerning the natural gas and petroleum industries, public utility regulation, energy policy, antitrust issues, and economic research and analysis. I have presented expert testimony in over one hundred thirty proceedings before numerous state and federal courts, before the FERC, and before various state public utility commissions. I have also testified as an energy expert in arbitration proceedings in Louisiana, New Mexico and Texas, before a Mediator in Ohio, and in Federal bankruptcy court. Attachment A identifies my prior expert testimony in other proceedings.

My Assignments

2. JWWA has been retained by the Plaintiffs in this litigation to analyze the Defendant's pricing and royalty payment practices for

carbon dioxide ("CO_2") gas produced from the Bravo Dome CO_2 gas unit in Northeast New Mexico. The Complaint of the Plaintiffs alleges that Kinder-Morgan is in breach of contract by underpaying the royalties and overriding royalties to private owners. As part of this analysis, we have been asked to:

a) Consider the claims of the Plaintiffs in their Class Action Complaint in the context of the terms of the Class Action Settlement Agreement in *Feerer et al. v. Amoco Production Co.* ("Settlement Agreement") and in that connection respond to the opinion testimony of Dr. Stephen Becker in his affidavit that the Plaintiffs' claims are not in breach of the Settlement Agreement but are challenges to Non-Qualified contracts or Non-Qualified Other Transportation Charges and must be submitted to arbitration.

b) Determine, among other things, the extent to which the CO_2 values used by Kinder-Morgan CO_2 Company to pay royalties to the Plaintiff, have reflected the value of CO_2 at the tailgate of the Bravo Dome plant, in conformance with the terms of the Settlement Agreement.

c) Evaluate the validity of the Kinder-Morgan transportation deductions from CO_2 prices in the Permian Basin in arriving at the imputed prices at Bravo Dome that were used to pay royalties to the Plaintiffs.

3. I am being compensated for my work, on this matter, on a time and expenses basis. My hourly rate is $250.

Related CO_2 Experience

4. Prior to and in connection with the consulting services being provided in this case, JWWA has made detailed studies of the production, transportation, and sale of compressed CO_2 for use as an injectant in enhanced oil recovery (EOR) projects. This prior experience includes the following:

   a) *Doris Feerer, et al. v. Amoco Production Company, et al.,* in the United States District Court for the District of New Mexico, case No. 95-0012-JC/WWD. Following the preparation and submission of expert reports in the Feerer case, Dr. John W. Wilson, President of JWWA, and I gave deposition testimony, and we were both designated by the Plaintiffs' attorneys as experts to give testimony at trial.

   b) *CO_2 Claims Coalition, LLC v. Shell Oil Company, et al.,* in the United States District of Colorado, case No. 96-Z-2451. The Plaintiffs in that case were the small share working interest owners, and a number of the fee royalty interest owners and overriding royalty interest owners in the McElmo Dome CO_2 field in Colorado: The Plaintiffs' claims in the McElmo Dome CO_2 litigation were also

similar to those being made by the Plaintiffs in this case.

c) *Gary H. Shores, et al. v. Mobil Oil Corporation, et al.,* in the Probate Court of Denton County, Texas, case No. GC-99-01184. The Plaintiffs in that case are a number of the fee royalty interest owners and overriding royalty interest owners in the McElmo Dome CO_2 field in Colorado. Their claims are similar to those being made in the other McElmo Dome CO_2 litigation.

d) *Ray Powell, Commissioner of Public Lands of the State of New Mexico, Trustee v. Amoco Production Company, et al.,* in the First Judicial District, State of New Mexico, County of Santa Fe, Case No. D-0101-CV-2000 02079 ("the State of New Mexico case"). In that case, the State of New Mexico, as a fee royalty interest owner in the Bravo Dome CO_2 field, made claims similar to those that have been made in the other CO_2 cases, including the claims being made by the Plaintiffs in this litigation. I gave deposition testimony and was designated as an expert witness by the Plaintiff's attorneys to testify at trial in the State of New Mexico case.

Other Related Experience

5. JWWA has had an active and ongoing practice for over thirty years in economic consulting in the oil and gas business, including crude oil and natural gas production, petroleum and natural gas pipeline operations, and the sale of petroleum and natural gas. We are generally familiar with the economic conditions that have influenced domestic petroleum markets since the 1970's, and especially during the time period covered by the Plaintiffs' claims in this case. I am familiar with the terms, concepts, practices, and methodologies that are generally and customarily used in the oil and gas business, including planning, operations, and the methods and procedures that are generally and customarily relied upon to measure economic values in the various domestic petroleum and natural gas markets.

Background on CO_2 Operations

6. Enhanced oil recovery, or EOR, refers to the methods used to obtain incremental oil production from crude oil reservoirs over that which can be economically recovered by conventional primary and secondary recovery methods. Primary methods rely on natural reservoir pressures or energy to drive the crude oil to the surface. But over time, this natural energy drive declines, and other energy must be added if significant additional crude oil is to be produced.

7. The Permian Basin producing area in West Texas and Southeast New Mexico is one of the most mature domestic crude oil producing areas. Given the physical characteristics of its reservoirs, the Permian Basin was long considered a prime candidate for EOR operations, including CO_2 miscible flooding. These facts, in combination with its relatively close proximity to three large CO_2 source fields in Northeast New Mexico and Southwest and Southeast Colorado, eventually resulted in the development in the 1980's of large-scale, commercial CO_2 for EOR operations in the Permian Basin crude oil industry.

8. Kinder-Morgan is one of only a few major participants in the CO_2 for EOR industry in the Permian Basin. Moreover, each of the largest owners of CO_2 at the three source fields has also been significantly involved in both the ownership of the three pipelines used to transport CO_2 from the source fields to the EOR fields, and in the EOR operations at those same oil fields in the Permian Basin.

9. The Permian Basin EOR area has obtained nearly all of its CO_2 supplies from the Bravo Dome CO_2 Unit in New Mexico, or from the McElmo Dome and Sheep Mountain CO_2 units in Colorado. Approximate percentage working interest shares in these three large source fields are as follows:

   a) *Bravo Dome*: Oxy, USA, Inc. ("OXY"), previously Amoco Production Company,

about 75%; Kinder-Morgan CO_2 Company, L.P., previously Shell, about 11%; Amerada Hess, about 10%; Exxon Mobil, previously Exxon, about 1.4%; and others, about 2.6%.

b) *McElmo Dome*: Kinder-Morgan, about 45%; and Exxon Mobil, about 44%, and others, about 11%.

c) *Sheep Mountain*: Exxon Mobil 50%; and BP-Amoco, previously Arco, 50%.

10. Approximate percentage ownership shares in the pipelines used to transport CO_2 from the three source fields to the EOR fields in the Permian Basin are as follows:

a) *Bravo Pipeline System (BPS)*: OXY, 81%; Kinder-Morgan, 13%; and XTO, previously Cross Timbers Oil Company, 6%.

b) *Cortez Pipeline Company (Cortez)*: Kinder-Morgan, 50%; Exxon *Mobil*, 37%; and Cortez-Vickers, 13%. Only Cortez-Vickers does not own an interest in the McElmo Dome CO_2 source field.

c) *Sheep Mountain Pipeline*: from the Sheep Mountain CO_2 source field to a point near the Bravo Dome CO_2 source field, where it interconnects with Rosebud Pipeline, Exxon Mobil, 50%; and BP-Amoco, 50%. From the Rosebud interconnection to the Denver City, Texas area, Exxon Mobil, 35%; BP-Amoco 35%; and Amerada Hess, 30%. Amerada Hess owns 100% of Rosebud Pipeline, which

transports CO_2 a short distance from the Bravo Dome source field to the Sheep Mountain Pipeline.

11. A very large percentage of the CO_2 produced by OXY, Kinder-Morgan, Amerada Hess, and Exxon Mobil at the Bravo Dome source field is used by each of them in their own respective EOR projects in the Permian Basin. Similarly, nearly all of the CO_2 produced at the Sheep Mountain source field has been used by Exxon Mobil and BP-Amoco at their EOR projects in the Permian Basin. Generally, at least 50%, and frequently much more than that, of the CO_2 produced by Kinder-Morgan at the McElmo Dome and Bravo Dome source fields has been used at its EOR projects in the Permian Basin.

Materials Examined

12. The sources that I have particularly reviewed and considered in connection with the preparation of this affidavit are the following:

    a) The April 1998 Class Action Settlement Agreement in *Feerer et al. v. Amoco Production Company* and Exhibit D-3 to that agreement entitled "Shell Qualified Contracts." Portions of the Settlement Agreement made September 24, 2001 in settlement of royalty litigation concerning the McElmo Dome Carbon Dioxide Unit. Concerning the latter agreement I focused on Sections 4 and 5 concerning

the requirements on Kinder-Morgan and Exxon Mobil in calculating future royalty and overriding royalty payments.

b) *Qualified contracts indexed to oil prices.*

- Contract 5, Meter No. 200A; CO_2 Sale and Purchase Contract between Shell Land and Energy Company and Shell Western E&P Inc., dated, December 1, 1994 (KMJCH 000021-47)
- Contract 6, Meter No. 200B; Wasson ODC Unit CO_2 Sale and Purchase Contract between Mabee Petroleum Corp. and Shell Western E&P Inc., dated May 1, 1993 (KMJCH 000048-76)
- Contract 12, Meter No. 221A; CO_2 Sale/Purchase Contract between Shell Western E&P Inc. and Shell Western E&P Inc., dated August 1, 1996 (KMJCH 000121-50)
- Contract 13, Meter No. 222; CO_2 Sale and Purchase Contract between Shell Onshore Ventures Inc. and Shell Western E&P Inc., dated July 1, 1996 (KMJCH 000151-80)
- Contract 15, Meter No. 204A; CO_2 Sale and Purchase Contract between Shell Western E&P, Inc. and Shell Western E&P Inc., dated August 1, 1996, and accompanying amendments (KMJCH 000181-000210)

- Contract 20, Meter No. 210D; CO_2 Sale and Purchase Contract between Shell Western E&P Inc. and Shell Western E&P Inc., dated August 1, 1996 (KMJCH 000211-50)

- Contract 23, Meter No. 215A; CO_2 Sale and Purchase Contract between Amoco Oil Company and Shell Western E&P Inc., dated March 1, 1997, and accompanying amendments (KMJCH 000251-88)

- Contract 42, Meter No. 223; CO_2 Sale and Purchase Contract between Seminole San Andres Unit and Shell Western Exploration and Production Inc., dated July 1, 1996, and accompanying amendments (KMJCH 000406-27)

- Contract 46, Meter No. 200C; CO_2 Sale and Purchase Contract between Arco Oil and Gas Company and Shell Western E&P Inc., dated October 1, 1993, and accompanying amendments (KMJCH 000428-88)

c) *Non-qualified contracts indexed to oil prices.*

- Contract 82, Meter No. 202E; Product Sale and Purchase Contract between Amerada Hess Corporation and Shell CO_2 Company, Ltd., dated October 1, 1998, and accompanying amendments (KMJCH 000573-601)

- Contract 235, Meter No. 280A; Product Sale and Purchase Contract between Altura Energy Ltd. and Shell CO_2 Company, Ltd., dated July 1, 1997, and accompanying amendments (KMJCH 000914-40)

- Contract 286, Meter No. 204B; CO_2 Purchase Contract between Kinder Morgan CO_2 Company, L.P. and Sonic Oil and Gas, L.P., dated August 1, 2002 (KMJCH 000491-93)

d) *Qualified contracts based on fixed prices.*

- Contract 7, Meter No. 210B; CO_2 Sale and Purchase Contract between Shell Frontier Oil and Gas Inc. and Shell Western E&P Inc., dated June 6, 1995 (KMJCH 000077-98)

- Contract 8, Meter No. 210C; CO_2 Sale and Purchase Contract between Shell Onshore Ventures Inc. and Shell Western E&P Inc., dated June 6, 1995 (KMJCH 000099-120)

- Contract 24, Meter No. 210A; CO_2 Sale and Purchase Contract between Bennett Ranch Unit Operator and Shell Western E&P Inc., dated June 6, 1995 (KMJCH 000289-312)

- Contract 31, Meter No. 212A; CO_2 Sale/Purchase Contract between Mobile Exploration and Producing U.S. Inc. and Shell Western E&P Inc.,

dated November 1, 1995 (KMJCH 000346-75)

- Contract 33, Meter No. 213A; CO_2 Sale/Purchase Contract between Transpetco Pipeline Company, L.P. and Shell Western E&P Inc., dated April 1, 1996 (KMJCH 000376-405)

e) *Non-qualified contracts based on fixed prices*

- Contract 233, Meter No, 211A; CO_2 Purchase Contract between Shell CO_2 Company Ltd. and Altura Energy Ltd., dated October 4, 1999 (KMJCH 000497-98)

- Contract 238, Meter Nos. 210G/211B; CO_2 Purchase and Sale Agreement between Altura Energy Ltd. and Shell CO_2 Company, Ltd., dated January 1, 2000 (KMJCH 000499-515)

- Contract 253, Meter No. 202F; CO_2 Purchase Contract between Kinder-Morgan CO_2 Company, L.P. and Amerada Hess Corporation, dated November 29, 2000 (KMJCH 000489-90)

- Contract 254, Meter Nos. 202H/211C; Product Sale and Purchase Contract between Marathon Oil (West Texas) L.P. and Kinder-Morgan CO_2 Company, Ltd., dated January 1, 2001 (KMJCH 000656-78)

- Contract 295, Meter Nos. 200G/201B; CO_2 Sale and Purchase Contract between Kinder Morgan CO_2 Company, L.P. and Occidental Petroleum Ltd., dated January 1, 2003, and accompanying amendments (KMJCH 000494-96)

- Contract 306, Meter No. 202G; CO_2 Sale and Purchase Contract between Kinder-Morgan CO_2 Company, L.P. and Amerada Hess Corporation, dated September 3, 2003 (KMJCH 000516-17)

f) *Contracts containing hidden consideration*

- Contract 28, Meter No. 260C; CO_2 Sale and Purchase Contract between Devon Energy Corporation (Nevada) and Shell Western E&P Inc., dated January 1, 1997 (KMJCH 000313-45)

- Contract 246, Meter Nos. 301A/601A; Product Sale and Purchase Contract between Occidental Permian Ltd. and Kinder-Morgan CO_2 Company, L.P., dated March 6, 2001, and accompanying amendments (KMJCH 000941-73)

- Contract 297, Meter Nos. 210H/200H/201C/201D; Product Sale and Purchase Contract between Occidental Permian Ltd. and Kinder

Morgan CO_2 Company, L.P., dated March 7, 2003 (KMJCH 000974-1 001)

g) Spreadsheets produced by Kinder-Morgan entitled "Post Settlement Bravo Dome Private Royalty Price Calculation By Delivery" for each month January 2000 through July 2004. I have reviewed and spot-checked some, but not all, of those reports to the extent that I understand what they purport to show. As a result of that review, I have arrived at certain observations regarding each Royalty Price Calculation sheet reviewed. In connection with this review I also examined Kinder-Morgan documents that reflect some data on CO_2 deliveries and pipeline volumes for the same month as the Royalty Price Calculation sheet. For example, the April 2004 Royalty Price Calculation is coupled with the delivery information for that month on documents 000700-000704.

h) Certain portions of my expert reports in *Powell v. Amoco Production Company* were revisited as a refresher of knowledge I have about the ownership and operation of CO_2 source fields Bravo Dome, McElmo Dome and Sheep Mountain, about the pipeline systems for transportation of the compressed CO_2 to EOR projects, and about the ownership and operation of EOR projects in the Permian Basin of West Texas and southeastern New Mexico.

i) A thirty-eight page, in color, illustrated presentation was printed from the Internet entitled "Kinder-Morgan CO_2 Tim Bradley," providing current information on Kinder-Morgan's CO_2 business generally; and specifically on its SACROC and Yates Field EOR projects.

j) The Affidavit of Dr. Stephen Becker dated September 15, 2004.

k) The Plaintiff's Class Action Complaint filed August 3, 2004 in this case.

Kinder-Morgan CO_2 Business

13. Kinder-Morgan is believed to be the largest producer at the combined Colorado and New Mexico CO_2 source fields. In calendar year 2004 Kinder-Morgan's CO_2 production amounted to approximately 13.2 billion cubic feet ("Bcf") at Bravo Dome and approximately 141.2 Bcf at McElmo Dome, for a total annual production of approximately 154.4 Bcf. That represented about 31.3% of total annual production in 2004 at the Bravo Dome, McElmo Dome, and Sheep Mountain CO_2 source fields.

14. Kinder-Morgan is the second largest user of CO_2 at the Permian Basin EOR projects. Kinder-Morgan's main EOR project is SACROC; it owns 97% of the field and is the operator. In calendar year 2004 Kinder-Morgan consumed approximately 124.2 Bcf at its EOR projects, and that amount represented nearly 26% of total annual CO_2 consumption

in 2004 at EOR projects in West Texas and New Mexico. Only OXY, at approximately 196 Bcf, consumed more CO_2 in 2004 for use in Permian Basin EOR projects.

Royalty Calculation Under The Settlement Agreement

15. As I previously stated, I am familiar with the Settlement Agreement in the Feerer case. A number of the provisions of the Settlement Agreement are especially relevant to issues in this litigation, and to the testimony of Kinder-Morgan's witness Stephen Becker. These include the following:

    - Par. 7.43 – Which defines "Unit CO_2" as gas produced from the Bravo Dome CO_2 Gas Unit, as saved and delivered into a pipeline or pipelines. The definition excludes gas from another CO_2 source, such as McElmo Dome.

    - Par. 9.3 – Which provides that Bravo Dome CO_2 royalty payments are to be based on the value of CO_2 at the "Unit Tailgate," i.e., compression, dehydration, and gathering costs shall not be deducted from the value or price of Unit CO_2 in calculating royalties.

    - Par. 11.2 (a) – Which provides that Kinder-Morgan and Hess are limited to taking an 11 cents/Mcf deduction in calculating their respective CO_2

royalty values for mainline transportation for all volumes transported and delivered from the Unit Tailgate to the Seminole San Andres Unit ("SSAU") or to the "Terminus Point" of the Bravo Pipeline System, near Denver City, Texas.

- Par. 11.3 – Which provides that any claim that Kinder-Morgan has used excessive transportation deductions or differentials, as described in Par. 11.1 and Par. 11.2, in deriving royalty settlement values shall be treated as a breach of the Settlement Agreement and not subject to mandatory arbitration, pursuant to Par. 16 of the Settlement Agreement.

- Par. 14 – This is the key provision that provides the weed specific royalty settlement methodology based on "benchmarks" to arrive at the Unit Tailgate prices to be used by Kinder-Morgan in calculating and paying royalties to Plaintiffs. Subparagraphs (a), (b) and (c) express the benchmarks that Kinder-Morgan "will utilize [in] the royalty settlement . . . " In summary they are: (a) "Unit CO_2" is the subject, (b) each individual lessee will use just their own weighted average price, (c) the prices or values will be established by Qualified Contracts (listed on Exhibit D-3) subject

to Qualified Transportation charges and the approved mainline deduction.

- Par. 14(e) identifies by exhibit the "Qualified Contracts" that are to be used in arriving at volume weighted average prices for royalty calculation purposes. 14(g) provides "Non-Qualified Contracts are "all contracts for the sale, exchange, or other disposition of CO_2 entered into by . . . Shell (Kinder-Morgan) after the date of this Agreement or not listed in Exhibit D-1, D-2 or D-3." In the case of Kinder-Morgan the Qualified Contracts are on Exhibit D-3. Thus, Non-Qualified Contracts are all contracts that are not identified as "Qualified Contracts" in the Settlement Agreement. 14(c) acknowledges that other benchmarks might be used in the future to determine royalty settlement values,

16. The parties agreed only to the use of known, existing and identified contracts for sale or disposition of CO_2 and specifically did not agree to the use of Non-Qualified Contracts in the agreed methodology for calculating settlement royalty values. Stated another way, the approved method in paragraph 14 (c) does not allow for the mixing of Non-Qualified Control prices with Qualified Contract prices. Accordingly, Kinder-Morgan on the one hand, and the Plaintiffs and members of the Class, expressly on the other, determined only to omit any "agreement

concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper."

17. In Par.4 of Dr. Becker's Affidavit in this case, he states that the net-back calculation and the associated volume-weighted average price to be used in calculating settlement royalty values "is contemplated to result from a mix of both Qualified and Non-Qualified downstream contract prices." This conclusion is not correct. Par.14(c) of the Settlement Agreement provides that the parties to the Settlement Agreement agreed only to the use of "Qualified Contracts" in the methodology to be used in calculating royalty settlement values. In my experience, sales agreements in the petroleum industry do not "contemplate" how things are to be done; rather, they express what the parties intend to be done, i.e., they say what they mean. Had the parties intended to include Non-Qualified Contracts in the 14(c) benchmark, it would have been easy to write that into the Settlement Agreement.

18. Although Par.14(c) of the Settlement Agreement, recognizes that some other methodology using "other benchmarks that may be utilized in the future to determine royalty settlement values that are not qualified or approved herein," may at some time in the future be used, no other methodology or other benchmark royalty settlement values were agreed to by the parties to the Settlement Agreement. Furthermore, it is only

logical that the parties to the Settlement Agreement, and in particular, the Plaintiffs in that case, would never have agreed to having their royalty settlement values calculated by the Defendants in that case on the basis of unknown future methodologies and benchmarks using volumes and prices in unknown future CO_2 sales agreements.

19. In Par. 7 of his Affidavit Dr. Becker states that "For the period of January 2000 to July 2004, Kinder-Morgan arrived at a royalty settlement value for payment of royalty to participating Feerer class members utilizing the weighted average net-back methodology called for in the Settlement Agreement. This conclusion is wrong. It is wrong because Kinder-Morgan did not calculate royalty settlement values on the basis of the methodology specified in Par.14 (c) of the Settlement Agreement, which sets forth the only methodology agreed to by the parties to the Settlement Agreement. As previously discussed, Par.14 (c) of the Settlement Agreement requires that only Qualified Contracts may be used in deriving prices or values, but as Dr. Becker acknowledges, during the period January 2000-July 2004, Kinder-Morgan included volumes and prices under Non-Qualified contracts in its calculations of royalty settlement values contrary to the Settlement Agreement terms.

20. There is additional evidence that appears just from limited discovery of other instances where Kinder-Morgan has not calculated

royalty settlement values in accordance with the Settlement Agreement. These include:

a) As previously discussed, Kinder-Morgan is limited to taking a deduction for mainline transportation for deliveries to the Seminole San Andres Unit of $0.11 per Mcf. Nevertheless, I have determined in my review of Kinder-Morgan's royalty price calculations that in a number of months, mainline transportation deductions significantly greater than $0.11 per Mcf were taken. For example, Kinder-Morgan often deducts, in addition to the approved Bravo Pipeline System deduction of $0.11 per Mcf, a so-called "SWPL Metering Rate," which has ranged between $0.02 per Mcf and $0.09 per Mcf. Metering costs are part of pipeline transportation costs and, under the Settlement Agreement, all mainline transportation costs are to be recovered only at the approved $0.11 per Mcf mainline rate. In addition, from time-to-time Kinder-Morgan has deducted a so-called "Add'l PL Tariff Rate" of $0.025 per Mcf for deliveries to Amerada Hess at the Seminole San Andres Unit, in calculating its netback royalty settlement values. As previously stated, deliveries to SSAU are limited to a mainline transportation rate of $0.11 per Mcf under the Settlement Agreement.

b) The evidence suggests that Kinder-Morgan has failed to use correct values

under a number of contracts, including both Qualified Contracts and Non-Qualified Contracts, in calculating royalty settlement values. By way of example, these instances apply at a minimum to the following contracts:

- The January 1, 1997 Qualified Contract between Devon Energy Corporation (Buyer) and Shell Western E&P, Inc. (Seller), now Kinder-Morgan. Under this agreement, in addition to agreeing to a CO_2 sales price of $0.41 per Mcf, Devon conveyed to Shell a 50% working interest in the Midcross (Devonian) Unit, at a total sales price of $1.00. During the months of April and May of 2002, Kinder-Morgan included volumes and prices under the Devon contract at a sales price of $0.41 per Mcf, with no recognition being given to the significant additional value that is associated with its own, cost-free 50% interest in that commercial EOR project.

- The March 6, 2001, Non-Qualified Contract between OXY (Buyer) and Kinder-Morgan (Seller). Under this agreement, in addition to the stated fixed sales prices of $0.66 per Mcf for the first 51.5 Bcf of CO_2 sold, and $0.64 per Mcf for the remaining 123.5 Bcf of CO_2 sold, the parties entered into a related Gas Processing

Agreement, whereby Kinder-Morgan processes at its nearby SACROC facilities gas produced by OXY at its Cogdell Unit. Kinder-Morgan's calculations of royalty settlement values include significant volumes and values for this CO_2 sales contract, but they give no recognition to the related economic value of the gas processing agreement that was entered into with OXY at the time of the CO_2 sales agreement was made.

- The August 1, 1996 Qualified Contract between Shell Western E&P (Buyer) and Shell Western E&P (Seller), both now being Kinder-Morgan. This agreement calls for a minimum contract price of $0.625 per Mcf, but for higher prices in the event West Texas Sour Crude Oil prices rise above $18.00 per barrel. During many months after January, 2001, Kinder-Morgan included volumes and values for this contract in its calculations of royalty settlement values, but at prices below $0.625 per Mcf, (e.g. 57¢) notwithstanding the fact that West Texas Crude prices had risen to levels well in excess of $18.00 per barrel. Then, beginning in April 2004, the price used by Kinder-Morgan for this contract in calculating royalty settlement values suddenly moved from $0.58 the previous month to $1.039 per

Mcf in April 2004 and to $1.15 per Mcf in July 2004, and remained at or above that higher level through July 2004. Based on my review of West Texas crude oil prices during the period January 2001 through July 2004, the correct contract prices for royalty settlement purposes should have been far greater than the contract prices that were used by Kinder-Morgan during most of that 43-month period.

21. My analysis of the Defendant's CO_2 pricing and royalty payment practices for this case is ongoing. The opinions and conclusions contained in this Affidavit are based, in part, on the limited discovery materials that have been produced to date by Kinder-Morgan. Therefore, I expect to develop additional opinions and conclusions as I continue my analysis and as more discovery materials are produced in this case.

/s/ George L. Donkin
George L. Donkin

SUBSCRIBED AND SWORN TO BEFORE ME this 18th day of February 2005.

/s/ [Illegible]
Notary Public, State of Virginia

My Commission Expires: November 30, 2007

George L. Donkin

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EDUCATION

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B.A., Economics, University of Maryland, 1970.

Mr. Donkin is a Vice President of J.W. Wilson & Associates, Inc., a consulting firm specializing in utility regulation, the economics of the natural gas industry, telecommunications studies, and antitrust economics. He is a nationally-recognized expert on energy and regulatory economics who has presented expert testimony on many occasions before federal and state courts, public utility regulatory bodies, arbitration panels and congressional committees.

Mr. Donkin's consulting work since 1974 has focused specifically on the following subjects:

- Natural gas and petroleum demand analysis.
- Energy supply contract negotiations.
- Petroleum and natural gas price forecasts.

- Crude oil and natural gas market value studies.
- Regulated utility revenue requirements and rate design.
- Energy supply procurement strategies.
- Property tax appraisals.
- Restructuring issues in the natural gas and electric utility industries.
- Competition and antitrust analysis.

A list of Mr. Donkin's publications and expert testimony is presented in Attachment.

[Attachment A Omitted In Printing.]

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit New Mexico similarly situated.

Plaintiffs,

vs.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant

No. D-818-CV-2004-00026

AFFIDAVIT OF DR. STEPHEN BECKER

STATE OF TEXAS)
) ss.
COUNTY OF Travis)

Stephen L. Becker; Ph.D., being first duly sworn on oath, deposes and says:

1. I am a founding Partner and Director of Applied Economics Consulting Group, Inc. ("Applied Economics") in Austin, Texas. Applied Economics conducts economic and financial analysis for a wide variety of clients across a number of industries. I

have an undergraduate degree in Computer Science and Engineering from the Moore School of Electrical Engineering at the University of Pennsylvania, a Master of Business Administration degree with a concentration in Finance from the University of Texas at Austin, and a doctorate in Public Policy from the LBJ School of Public Affairs at the University of Texas at Austin.

2. I have significant experience with corporate financial analysis, economical analysis, and economic and financial modeling. I have extensive experience in the oil and gas industry over the last 23 years. I have been engaged as an expert in various matters involving carbon dioxide. In the course of these matters I have performed extensive research and analysis of issues surrounding production, transportation and marketing of CO2. I have conducted studies and investigations of the Bravo Dome CO_2 Unit located in the State of New Mexico in regard to the Doris Feerer, et al vs. Amoco, et al litigation, the Powell vs. Amoco, et al litigation and various non-litigation assignments. I have also conducted studies and investigations concerning the McElmo Dome (Leadville) Unit in regard to several litigation matters. I am currently serving as the defendants' designated expert for the administration of the CO2 Claims Coalition settlement at the McElmo Dome field in Colorado. In that capacity I provide an annual review of all contracts of the sale of CO2 from the McElmo Dome field and an analysis of whether those contracts reflect "market value" per the terms of that settlement agreement. As such, I have relevant experience in and an understanding of the issues present in this matter and both my

academic and professional experiences qualify me to present this affidavit.

3. I have reviewed the Settlement Agreement from the Feerer matter, a copy of which is attached as Exhibit 1 to the Motion to Compel Arbitration (the "Motion"), and in particular have studied the provisions relating to the terms under which the Feerer defendants (and therefore Kinder Morgan as successor-in-interest to Shell) are to compute and pay royalty to class members.

4. The Settlement Agreements sets forth in detail the process by which Kinder Morgan should be paying royalties to the Feerer settlement class members. In summary, this process contemplates that Kinder Morgan will pay its owners on an entitlements basis using a volume weighted average of its respective prices for Unit CO2 utilizing a net-back from downstream sales or other dispositions. The Settlement Agreement specifically identifies certain sales and/or disposition contracts as "Qualified Contracts". Similarly, the Settlement Agreement identifies and defines "Approved Mainline Deductions" and "Qualified Other Transportation Charges". The Settlement Agreement further defines "Non-Qualified Contracts" and "Non-Qualified Other Transportation Charges". As such, the net-back calculation – and the resulting volume-weighted average price – is contemplated to result from a mix of both Qualified and Non-Qualified downstream contract prices that are then reduced by a mix of both Qualified and Non-Qualified Other Transportation Charges and the Approved Mainline Deduction.

5. Settlement Agreement §16 further stipulates that any claims against Shell (and hence Kinder Morgan) regarding the price of value under Non-Qualified Contracts (or under amendments to or extensions of Qualified contracts) that are utilized in establishing royalty settlement values shall be submitted to binding arbitration. Similarly, Settlement Agreement §16 stipulates claims regarding Non-Qualified Other Transportation Charges (or under amendments to or extensions of Qualified Other Transportation Charges) that are utilized in establishing royalty settlement values shall be submitted to binding arbitration.

6. I have reviewed and analyzed the process by which Kinder Morgan determined and paid royalty on CO2 from the Bravo Dome Unit to Plaintiffs and the putative class in this matter since January 2000. My analysis included the following steps:

   a. Review and analysis of the royalty calculation worksheets used to establish the royalty settlement price for parties to the Settlement Agreement for each month from January 2000 through July 2004 (attached to the Motion as Exhibits 2-6);

   b. Review of all sales contracts used as the basis for royalty settlement calculations described in step(a) (a summary of which is attached to the Motion as Exhibit 7); and

   c. Review of a sample of remittance statements for J. Casper Heimann and the other named plaintiffs in the Bravo Dome Unit covering

the January 2000 to July 2004 time period (attached the Motion as Exhibit 8).

7. Based on my review and analysis, I have determined the following:

   a. For the period January 2000 to July 2004, Kinder Morgan arrived at a royalty settlement value for payment of royalty to participating Feerer class members utilizing the weighted average net-back methodology called for in the Settlement Agreement. Specifically, Kinder Morgan determined the royalty settlement values for class members using a volume weighted average net-back calculation involving five components:

      i. Downstream prices and values for CO2 under Qualified Contracts;

      ii. downstream prices and values for CO2 under Non-Qualified Contracts (including amendments to or extensions of Qualified Contracts); plus

      iii. deductions from downstream prices and values for Qualified Other Transportation charges;

      iv. deductions from downstream prices and values for Non-Qualified Other Transportation Charges (including amendments to or extension of Qualified Other Transportation Charge); and

      v. deduction of the Approved Mainline Deduction of $0.11 per mcf.

b. Individual class member royalty payments were based on the per-mcf settlement price determined per this process each month times each class member's respective entitlement volume for the month.

8. I have reviewed the complaint in the above-referenced matter. Based on my review of the complaint, the relevant economic claim of the plaintiffs is an allegation that Kinder Morgan has underpaid royalties to the class since January 1, 2000. Based on the analysis described above, I have determined that class members' royalty values were based exclusively on Qualified Contracts. Non-Qualified Contracts, Qualified Other Transportation Charges, Non-Qualified Other Transportation Charges and the Approved Mainline Deduction. My understanding is that Qualified Contracts, Qualified Other Transportation Charges, and the Approved Mainline Deduction were approved by the class and hence, are not subject to challenge. Therefore, any challenge to the values paid is, from an economic standpoint, necessarily a challenge to Non-Qualified Contracts or Non-Qualified Other Transportation Charges.

Dated this 15th day of September, 2004.

/s/ Stephen Becker, Ph.D.
Stephen Becker, Ph.D.

Subscribed and sworn to
before me this 15th day of
September, 2004.

/s/ Leona Johnson
Notary Public, Travis County,
State of Texas

My Commission Expires
7/22/2006

[SEAL]	LEONA JOHNSON Notary Public State of Texas My Commission Expires July 22, 2006

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,	)	No. 04-26 CV
Plaintiffs,	)	
VS.	)	
KINDER-MORGAN CO2 COMPANY, L.P.,	)	
Defendant.	)	

* *

ORAL DEPOSITION OF
STEPHEN L. BECKER, Ph.D.
February 18, 2005

* *

ORAL DEPOSITION OF STEPHEN L. BECKER, Ph.D., produced as a witness at the instance of the Plaintiffs, and duly sworn, was taken in the above-styled and numbered cause on the 18th day of February, 2005 from 11:00 a.m. to 2:04 p.m., before Marlene Erives, CSR in and for the State of Texas, reported by machine transcription, at the Law Offices

of Vinson & Elkins, 2801 Via Fortuna, Suite 100, Austin, Texas, pursuant to Rules 1-026 and 1-030 of [2] the New Mexico Rules of Civil Procedure for District Courts and the provisions stated on the record and attached hereto.

* * *

[66] price on which the royalty's paid?

A. From the face of the check stub, I would say there's – there's nothing in here that would – you can't tell from the check stub which contracts, be that it's qualified or non-qualified – I mean, looking at this you wouldn't know when qualified contract number 3 was discontinued and was no longer being used.

Q. Or you wouldn't know that only qualified contracts were being used to arrive at the price?

A. That's correct. I, mean the check stub is not at that level of detail. And I don't see anything, and maybe there's a section you can point me to if I just missed it in my review of this, where the parties set forth a desire to have that level of detail.

Q. Well, do you know anything that's been done by Kinder-Morgan to inform the other parties to this agreement, that is, the royalty owners, that other benchmarks are to be used, and the other benchmark is to [67] include non-qualified contracts?

A. No. I don't know one way or the other.

Q. Well, Kinder-Morgan has provided you no information to the effect that they have disclosed that

to the royalty owners since the settlement agreement was made; is that a fact?

A. That's a fact.

Q. Did you compile any kind of a list that indicates the nature of the contracts, qualified or non-qualified, that were used in these – Exhibit 4, example, royalty calculation spreadsheets?

* * *

[77] is attributed to that delivery. So, yes, it would be a benchmark different from the price, the price or value you'd see under qualified contracts.

Q. So the other benchmark, then, can come into use unilaterally; that is to say, simply by Kinder-Morgan deciding it's going to use some non-qualified contracts, [78] it can initiate another benchmark for calculation of the royalty?

A. Yeah. I mean, I wouldn't characterize it as "initiate another benchmark" because in my mind it leaves a reader with the impression that you've done this whole sale change from when we were doing it this way, and we unilaterally decided to pick up and go value it on this other thing. The use of prices and values obtained under non-qualified contracts is a benchmark different from those that you get from qualified contracts. And I would agree that per the terms of the settlement agreement, I don't see anything that says that Kinder-Morgan has to get permission from anyone to begin using non-qualified contracts, nor do I see anything in here that requires

that Kinder-Morgan provide any notice that it's doing so. The settlement agreement anticipates that it's going to be done in my reading of it. But I don't see any approval step called for here.

Q. So the settlement agreement in speaking to other benchmarks contemplates or anticipates that one of these parties to the agreement without participation by the other parties to the agreement can adopt another or a different benchmark?

A. They can't adopt a new methodology, but they can – the components of the ultimate price that is paid [79] can include other benchmarks other than qualified contracts without notice to the other party.

Q. Right. In other words, unilaterally that can be done?

A. Yes.

Q. Do you know whether after this agreement was made in 1998 and in 1999, whether Shell used only approved or qualified, I should use the word "qualified," contracts in order to calculate and pay the royalty?

A. I don't know one way or the other. I haven't done any review of their royalty payments.

MR. GALLEGOS: I think that's all my questions.

MR. LIPE: We'll reserve ours.

(Deposition concluded at 2:04 p.m.)

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

RUSSELL GARY HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant.

No. 04-26 CV

(Filed Aug. 9, 2007)

CLASS CERTIFICATION ORDER

THIS MATTER came before the Court on July 30, 2007 for consideration of the Plaintiffs' Motion for Class Certification filed September 17, 2004. The Court ordered additional briefing which has been completed. Plaintiffs' Supplemental Brief served February 22, 2005, narrowed the claims sought to be certified by plaintiffs to breach of contract, breach of the implied covenant of good faith and breach of the implied covenant to market. The Court has reviewed the extensive memoranda, affidavits and documents submitted by the parties and the relevant authorities.

The Court FINDS and CONCLUDES that the plaintiffs have met the requirements of Rule 1-023(A) and (B)(3) NMRA for class certification on the contract claims set forth in the Complaint with respect to breaches of the Feerer Settlement Agreement as follows:

1. After the initiation of this action, the plaintiff J. Casper Heimann died. In his place as a plaintiff is his son Russell Gary Heimann. The other plaintiffs are Pecos Slope Royalty Trust and Rio Petro Ltd. All plaintiffs are owners of royalty and overriding royalty burdening leases held by defendant Kinder-Morgan CO2 Company, L.P. ("Kinder-Morgan") in the Bravo Dome Carbon Dioxide Unit ("Unit") located in Union, Harding and Quay Counties, New Mexico.

2. Plaintiffs have brought a class action on behalf of the Unit royalty and override interest owners to recover damages allegedly resulting from Kinder-Morgan improperly calculating and paying royalties on carbon dioxide ("CO2") produced from the Unit by it.

3. Plaintiffs are parties to, or successors or assigns of parties to, the Class Action Settlement Agreement in the federal court proceeding styled *Doris Feerer, et al. v. Amoco Production Company* in United States District Court of the District of New Mexico, Civ. No. 95-0012 JC/WWD ("Feerer Class Action"). The *Feerer* class action Settlement Agreement included Shell CO2 Company Ltd., Kinder

Morgan's predecessor-in-interest, and other Unit working interest owners.

4. Plaintiffs allege that they and all class members have been damaged because Kinder-Morgan has allegedly failed to calculate and pay the royalty and overriding royalty on the proper value of the produced CO2 in accordance with the *Feerer* Settlement Agreement. Plaintiffs claim that Kinder-Morgan's actions breach the *Feerer* Settlement Agreement. Kinder-Morgan denies each of these allegations.

5. The class consists of approximately 600 members. It is so numerous that joinder of all members is clearly impractical.

6. The rights and obligations of plaintiffs, class members and the defendant are based on the *Feerer* Settlement Agreement. The issues concerning alleged breaches of the *Feerer* Settlement Agreement and alleged attendant implied covenants and duties arising under the *Feerer* Settlement Agreement present common issues of fact and law.

7. Kinder-Morgan has calculated and paid royalties and overrides to all its royalty and overriding royalty owners in the Unit on the same basis each month according to each royalty and override owner's respective fractional ownership interests in the Unit. The claims of the named plaintiffs are based on the same alleged improper prices and are typical of the claims of the class members.

8. The plaintiff Russell Gary Heimann and the plaintiff entities, by trustees and partners, Robert P. Creson and Cynthia Clendenen, are prepared to prosecute the case on behalf of the class. Their interests are compatible with the class and they have employed experienced and expert legal counsel who have specialized in oil and gas law, in complex litigation and handled numerous class actions.

9. The plaintiffs have narrowed the claims for which they seek certification to only their contract-based claims for alleged breach of the *Feerer* Settlement Agreement and alleged breach of alleged implied obligations and duties arising under the *Feerer* Settlement Agreement. The issues inherent in those claims are subject to generalized proof and would require no individual proof as to liability.

10. A class action is the only practical way to adjudicate the claims of the royalty/override owners against Kinder-Morgan. For a large number of the class the costs to individually litigate their claims would exceed any potential recovery they might have.

11. This is a New Mexico case even though some class members reside in other jurisdictions. Because of the aggregation of significant contacts creating New Mexico interest in this matter the law of this forum should control and application of the forum law to the class issues will not violate constitutional principles of due process.

12. The numerosity, commonality and typically requirements of Rule 23(A)(1), (2 and (3) NMRA are

satisfied with regard to claims for which Plaintiffs seek certification as described in paragraph 9 above.

13. The requirements of Rule 23(A)(4) NMRA are satisfied with regard to the claims for which Plaintiffs seek certification as described in paragraph 9 above where here the class plaintiffs are represented by qualified attorneys and the plaintiffs have a strong interest in proving the allegations concerning Kinder-Morgan's conduct and protecting the interests of the class.

14. The requirements of Rule 23(B)(3) NMRA are satisfied with regard to the claims for which Plaintiffs seek certification as described in paragraph 9 above because questions of law or fact raised by such claims are common to the members of the class and predominate over any questions affecting individual members.

15. The defendant Kinder-Morgan does not oppose the grant of plaintiffs' motion for class certification with regard to claims for alleged breach of the *Feerer* Settlement Agreement and alleged breach of alleged implied obligations and duties arising under the *Feerer* Settlement Agreement.

IT IS THEREFORE ORDERED as follows:

1. The Court has jurisdiction of the subject matter and jurisdiction and venue in Union County is proper.

2. The plaintiffs' motion for class certification should be and is GRANTED only with regard to the claims described below.

3. The Court certifies this action as a class action under Rule 1-023(B)(3) NMRA only with regard to claims for alleged breach of the *Feerer* Settlement Agreement and for alleged breach of alleged implied obligations and duties arising under the Feerer Settlement Agreement, and to that extent, this action shall be maintained and proceed as a class action on behalf of the following class:

> All present and former owners of royalty interests since January 2000 that burden leases, or of overriding royalty interests that burden working interests, held by defendant Kinder-Morgan CO2 Company, L.P. (its predecessors and successors) in the Bravo Dome Unit who were settling plaintiffs or settling class members under the Class Action Settlement Agreement in Feerer, et al. v. Amoco Production Company, et al. USDC, Dist. NM, CIV 95-0012 JC/WWD, or are successors, heirs or assigns of such settling plaintiffs or settling class members; excluding the defendant and all of its corporate parents, subsidiaries or affiliates.

4. The causes of action that are certified for class treatment are limited to claims for : (a) breach of the Feerer Settlement Agreement; (b) breach of the alleged duty of good faith and fair dealing under the *Feerer* Settlement Agreement; and (c) breach of the

alleged implied covenant to market under the *Feerer* Settlement Agreement.

5. Russell Heimann, Pecos Slope Royalty Trust, and Rio Petro Ltd. are designated as the class representatives, and the law firms of Gallegos Law Firm, P.C. and the Alsup Law Office are designated as counsel for the class.

6. Except as expressly provided herein to the contrary, plaintiffs' motion for class certification is denied.

DATED July 30, 2007.

/s/ Eugenio S. Mathis
Honorable Eugenio S. Mathis
District Court Judge

SUBMITTED BY:

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(3)

No. 07-164

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SUPREME COURT, U.S.

In The

Supreme Court of the United States

KINDER MORGAN CO_2 COMPANY, L.P.,

Petitioner,

v.

RUSSELL GARY HEIMANN, PECOS SLOPE ROYALTY TRUST AND RIO PETRO LTD., INDIVIDUALLY AND ON BEHALF OF ALL OTHER PRIVATE ROYALTY AND OVERRIDING ROYALTY OWNERS IN THE BRAVO DOME CARBON DIOXIDE UNIT, NEW MEXICO, SIMILARLY SITUATED,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeals Of New Mexico

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

I. The Split in the Circuits Regarding Application of the Presumption in Favor of Arbitration to Narrow Arbitration Clauses is Substantive and Substantial.

Plaintiffs argue that "[w]hile different courts may articulate the standard to determine arbitrability [under narrow clauses] differently, they all apply the same standard substantively," and that a review of the decisions "indicates that the differences in language are semantic differences that do not affect the substantive analysis all courts apply." Response Brief 4, 31. The decisions cited in the Petition demonstrate that Plaintiffs are wrong and that the circuit split is substantive and substantial.

The Third Circuit holds that the presumption in favor of arbitration is "inapposite" to narrow arbitration clauses.[1] The Second, Eighth, and Tenth Circuits hold that a claim is arbitrable under a narrow clause only if it "is on its face within the purview of the clause."[2] The Fifth, Eleventh, and D.C. Circuits hold

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[1] *Trap Rock Industries Inc. v. Local 825, Intern. Union of Operating Engineers, AFL-CIO*, 982 F.3d 884, 888 n.5 (3d Cir. 1992); Local 827, *Intern. Broth. Of Elec. Workers, AFL-CIO v. Verizon New Jersey, Inc.*, 458 F.3d 305, 310-311 (3d Cir. 2006).

[2] *Louis Dreyfus Negoce S.A. v. Blystad Shipping and Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001); *Twin City Monorail, Inc. v. Robbins & Myers, Inc.*, 728 F.2d 1069, 1072-1073 & nn.3, 4 (8th Cir. 1984); *Cummings v. FedEx Ground*, 404 F.3d 1258, 1262 (10th Cir. 2005).

that the presumption in favor of arbitration is fully applicable to both narrow and broad clauses.[3] As shown in the Petition, the state courts also are divided on the proper standard to be applied in determining arbitrability. There is no basis for Plaintiffs' contention that the differences in approach exhibited by these decisions are not substantive and involve only "semantics." The standard for determining whether claims relating to a contract containing a narrow arbitration clause are resolved in court or arbitration varies depending on where the case is filed.

II. The New Mexico Court of Appeals Utilized a Restrictive Approach to the Application of the Presumption Favoring Arbitration, Both With Regard to Plaintiffs' Contract Claims and Non-Contract Claims.

Plaintiffs claim that the conflict in the circuits on the application of the presumption favoring arbitration to narrow arbitration clauses is a "false issue because the New Mexico Court of Appeals did not apply the more restrictive test" for application of that presumption. Response Brief 4. That assertion is

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[3] *Intern. Brotherhood of Elec. Workers, Local 2188 v. Western Electric Co., Inc.*, 661 F.2d 514, 516 n.3 (5th Cir. 1981); *Ivax Corp. v. B. Braun of Am., Inc.*, 286 F.3d 1309, 1320 n.23 (11th Cir. 2002); *Washington Mailers Union No. 29 v. Washington Post Co.*, 233 F.3d 587, 592 n.4 (D.C. Cir. 2000).

demonstrably false, both with regard to Plaintiffs' contract claims and Plaintiffs' non-contract claims.

A. The Contract Claims

In discussing the presumption favoring arbitration, the New Mexico court of appeals cited a prior New Mexico case holding that "the arbitration agreement will be given broad interpretation *unless the parties themselves limit arbitration to specific areas or matters.*" App. 8 (quoting *McMillan v. Allstate Indem. Co.*, 135 N.M. 17, 84 P.3d 65 (2004) (emphasis added)). Noting that "the language in the settlement agreement emphasizes the narrow scope of the arbitration clause," the court then held that rules of contract construction governed the interpretation of the exclusionary clause relating to claims for breach of the settlement agreement, making no further reference to the presumption favoring arbitration in determining whether Plaintiffs' contract claims were arbitrable. App. 9, 12-13. The court broadly interpreted the exclusionary clause to preclude arbitration of any claim in which Plaintiffs characterized Kinder Morgan's conduct as a breach of the settlement agreement, "regardless of whether they may involve prices of non-qualified contracts," and without any analysis of whether that broad interpretation of the exclusionary

clause precluded arbitration of the very type of claims that the arbitration clause was designed to cover.[4] *Id.*

Kinder Morgan argued that the exclusion from arbitration for "future claims for breach of this agreement" was intended to preclude arbitration of claims based on the deduction of Non-Qualified charges of the type that the agreement expressly prohibited, and that the exclusion did not exclude from arbitration claims based on the royalty payments resulting from the use of Non-Qualified prices and charges on which the parties "omit[ted] any agreement" in Section 14(c) of the settlement agreement. The New Mexico court of appeals never addressed that narrower interpretation of the exclusionary clause. The court inexplicably stated that Kinder Morgan's position "would leave essentially no viable claims that would not be subject to arbitration,"[5] but the court did not address Kinder Morgan's argument that the exclusion from arbitration would and should preclude arbitration if Kinder Morgan violated one of the provisions that prohibited certain types of Non-Qualified deductions, such as those found in Sections 9.2, 10, 11.2, and 11.4.[6] Nor did the court consider Kinder Morgan's argument that a claim challenging royalty payments that used Non-Qualified prices and charges on which the parties

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[4] The court of appeals never explained what would remain arbitrable under its broad interpretation of the exclusionary clause.

[5] See App. 6.

[6] See App. 88-96.

"omit[ted] any agreement" under Section 14(c) cannot constitute a "future claim for breach of this agreement" for purposes of the exclusionary clause in Section 16 of the settlement agreement.

Contrary to the New Mexico court of appeals' approach, the proper application of the presumption favoring arbitration to the interpretation of an exclusionary clause is illustrated by the Fourth Circuit's decision in *Choice Hotels Intern. Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707 (4th Cir. 2001). In that case, the court interpreted an exclusionary clause that excluded from arbitration "actions for the collection of money owed . . . under this agreement." *Id.* at 710. The court rejected the plaintiffs' proposed interpretation of the exclusionary clause as covering all contract claims seeking money damages, instead holding that the exclusionary clause was limited to "traditional collection actions." *Id.* at 711. Noting that the plaintiff's broad interpretation of the exclusion would leave little subject to arbitration, the court held that the presumption favoring arbitration required a "narrow reading of the . . . exemption and a corresponding expansive construction of the general arbitration requirement." *Id.*

The New Mexico court of appeals conducted no such analysis. In their effort to avoid the conflict between the New Mexico court's approach and that of the Fourth Circuit in *Choice Hotels*, Plaintiffs argue that the arbitration clause in *Choice Hotels* was broad, while the clause in this case is narrow. Response Brief 32. That asserted justification

constitutes an acknowledgement by Plaintiffs that the New Mexico court applied a more restrictive approach in applying the presumption favoring arbitration to narrow clauses than broad clauses, contrary to Plaintiffs' other arguments in their Response Brief. In any event, the clause in *Choice Hotels* did not cover all disputes between the parties, but carved out three different categories of claims from arbitration. *Id.* at 709-710. The Fourth Circuit nevertheless held that the presumption favoring arbitration required a narrow interpretation of the exclusionary clause which would not eviscerate the right to arbitration created by the arbitration clause. *Id.* at 711.

Plaintiffs' second argument regarding *Choice Hotels* is that "New Mexico courts are not bound by Fourth Circuit precedent." Response Brief 32. In essence, Plaintiffs' argument is that the New Mexico state courts are permitted to issue decisions that are in conflict with the decisions of federal circuit courts of appeals in the United States. It is precisely that type of conflict that S. Ct. R. 10(b) addresses as a reason considered by this Court in granting certiorari.

The New Mexico court also improperly denied arbitration based on the Plaintiffs' unilateral characterization of their claims. While Plaintiffs attempt to create the impression in their Response Brief that the court of appeals went behind the legal labels that the Plaintiffs assigned to their claims, the opposite is true. With regard to both Count III and Count IV of

the complaint, the court simply held that because the Plaintiffs alleged that Kinder Morgan's conduct constituted a breach of the settlement agreement, the claims were not subject to arbitration. See App. 12-13 ("As stated in the complaint and on appeal, Plaintiffs' third claim alleges breach of the settlement agreement. It, therefore, is not subject to arbitration. . . . Plaintiffs thus allege breach of the settlement agreement in their fourth claim. This claim, as stated in Plaintiffs' complaint, is not subject to arbitration.") By holding that Plaintiffs' characterization of their claims was controlling, the court of appeals adopted a rule that conflicts with federal court of appeals decisions cited in the Petition at pages 25-26.[7]

B. The Non-Contract Claims

The New Mexico court of appeals also took a restrictive approach to application of the presumption favoring arbitration in denying arbitration of the non-contract claims. The court concluded that it was "not clear whether Plaintiffs challenge the prices under non-qualified contracts" in their non-contract claims, and it held that "based on the lack of clarity in Plaintiffs' complaint and subsequent statements," the district court did not commit error in refusing to compel arbitration. App. 18. The court of appeals thus

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[7] *In re Oil Spill by Amoco Cadiz*, 659 F.2d 789, 794 (7th Cir. 1981); *J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A.*, 863 F.2d 315, 319 (4th Cir. 1988).

resolved doubts in favor of court litigation rather than arbitration. In support of that holding, the court of appeals cited the Tenth Circuit's decision in *Cummings v. FedEx Ground*, 404 F.3d at 1262, which applied a restrictive approach to the presumption favoring arbitration, and the New Mexico court said that "*given the narrow scope of the arbitration agreement in this case*, it is inappropriate to compel arbitration when Plaintiffs *may* not dispute the prices under non-qualified prices at all." App. 18 (emphasis added).

Thus, the court of appeals refused to resolve doubts concerning the arbitrability of Plaintiffs' non-contract claims in favor of arbitration, based on the narrow scope of the arbitration agreement. The court's decision directly implicates the circuit split concerning the proper application of the presumption favoring arbitration in the context of narrow arbitration clauses and it adopts a rule that encourages vague and artful pleading.[8]

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[8] Plaintiffs argue that there is no evidence that they engaged in artful pleading. That argument misses the point. Regardless of the subjective motivation for Plaintiffs' vague pleadings, the rule adopted by the New Mexico court permits plaintiffs to avoid arbitration by pleading in vague terms or artfully pleading their case to circumvent the arbitration agreement. By resolving doubts in favor of arbitration, courts obviate the necessity for a subjective analysis into a plaintiffs' motivation. None of the cases cited in the Petition requiring that doubts resulting from vague pleadings be resolved in favor of

(Continued on following page)

III. The Non-Contract Claims Remain in the Case

Plaintiffs assert in their Response Brief that the issues presented in the Petition relating to the non-contract claims are not live issues because the trial court entered an order denying class certification of the non-contract claims. Response Brief 18. The fact that the Plaintiffs withdrew their request for class certification of the non-contract claims, resulting in an order denying class certification of those claims, does not take those claims out of the case. Plaintiffs' withdrawal of their request for class certification of non-contract claims means that those claims are asserted by the Plaintiffs only their individual capacities, and not on behalf of the class. The non-contract claims remain in the case as individual claims, and the issues presented in the Petition relating to those claims are worthy of review.[9]

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arbitration (see Petition at 22) require any inquiry into a plaintiff's subjective motivations.

[9] Plaintiffs' Response Brief implies that the limitation of class certification to the contract claims is a recent event. Response Brief 18. In fact, as the class certification order states on its face, Plaintiffs withdrew their request for certification of the non-contract claims in February 2005 (Resp. App. 57), yet the parties appropriately have continued to litigate in the trial court and on appeal the arbitrability of the non-contract claims, as those claims remain in the case, asserted by the named plaintiffs in their individual capacities.

IV. Plaintiffs Make Numerous Misstatements in Their Response Brief.

In their Response Brief, Plaintiffs accuse Kinder Morgan of making misstatements to this Court. Those accusations are unfounded.[10] Actually, Plaintiffs' Response Brief contains numerous statements, designed to suggest that this case does not present issues worthy of this Court's review, which are inaccurate, incomplete, or directly contrary to the true facts. The following examples are particularly noteworthy:

1. Plaintiffs argue that the court of appeals' decision is correct because the arbitration clause applies only if Kinder Morgan gives advance notice to all class members of its intent to use Non-Qualified prices in its royalty calculations and if the parties are unable to reach agreement concerning such use. Response Brief 24. Plaintiffs fail to inform this Court that the court of appeals expressly rejected that interpretation of the settlement agreement, stating that the Plaintiffs' interpretation was unreasonable because "it allows arbitration only when Kinder

[10] For example, at page 13 of their Response Brief, Plaintiffs accuse Kinder Morgan of making statements at page 6 of the Petition that purportedly are inaccurate. Response Brief 13. The statements described on page 13 of the Response Brief are not made anywhere in the Petition.

Morgan has followed specific procedures that do not appear within the settlement agreement." App. 6-7.[11]

2. Plaintiffs argue that their contract claims do not include claims regarding the use of Non-Qualified prices, stating that they "cannot explain why the Court of Appeals" characterized the contract claims as challenging the use of Non-Qualified prices in the royalty calculations." Response Brief 29. They also suggest that the court of appeals contradicted itself on this issue by virtue of a statement at App. 18 that "Plaintiffs may not dispute the prices under non-qualified contracts at all." *Id.* That latter statement by the court of appeals related to the *non-contract* claims, not the contract claims as suggested by Plaintiffs in their Response Brief. App. 17-18. Additionally,

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[11] Plaintiffs assert that the unit operator, OXY USA, Inc. ("Oxy"), responded to the same claims by arguing that the claims were not arbitrable, and Plaintiffs assert, outside the record in this case, that the claims against Oxy were settled in 2005, prior to a jury trial. Response Brief 5 n.2. Plaintiffs fail to disclose to this Court other facts outside the record in this case but which are a matter of public record in Plaintiffs' lawsuit against Oxy, *i.e.*, that Plaintiffs took the position in their lawsuit against Oxy that "[n]ot a single Non-Qualified contract plays a part in Oxy's valuation method," unlike Kinder Morgan's valuation methodology, and that Oxy did in fact file a motion to compel arbitration after discovery was completed, with Plaintiffs arguing that Oxy waived its arbitration rights by filing a lawsuit. "Plaintiffs' Memorandum in Response to Defendant's Motion for Partial Summary Judgment on Breach Claims and to Compel Arbitration" filed August 23, 2005 in *Heimann v. OXY USA, Inc.*, Case No. 04-24-CV, in the District Court of Union County, New Mexico, at 2, 6.

a supplemental brief and supporting affidavit that Plaintiffs filed the day before the hearing on the motion to compel arbitration (reproduced in the Appendix attached to the Response Brief) demonstrate definitively that Plaintiffs *are* challenging Kinder Morgan's use of Non-Qualified prices in the royalty calculations, as noted by the court of appeals and contrary to Plaintiffs' statements in their Response Brief.[12]

3. Plaintiffs assert that "most of the CO_2 upon which Kinder Morgan is obligated to pay royalty is not bought or sold but is delivered in-kind for Kinder Morgan's own use." Response Brief 6-7. That statement is false. The evidence attached to the motion to compel arbitration demonstrated that the Bravo Dome CO_2 is sold under contracts to other parties, copies of which have been produced to Plaintiffs in discovery.

4. Plaintiffs assert that the motion to compel arbitration was filed two months after the complaint was filed, implying that the motion was an afterthought. Response Brief 7. In fact, Kinder Morgan's

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[12] In the supplemental brief, Plaintiffs complained that "Kinder-Morgan has used CO_2 prices from non-approved, Non-Qualified Contracts mixed with approved contract prices to determine and pay royalty" and that the parties "did not agree to the use of Non-Qualified Contracts in the agreed methodology for calculating settlement royalty values." Resp. App. 10, 13. Plaintiffs' supporting expert affidavit repeatedly challenged the propriety of Kinder Morgan's use of Non-Qualified prices in the royalty calculations. See Resp. App. 37-39.

first pleading, its answer, raised the arbitration argument which was also presented by motion promptly after challenges to judges initially assigned to the case were resolved and the actual trial judge was appointed.

5. Plaintiffs filed a brief in the trial court that said that the case "involves a search for truth behind the Non-Qualified Contracts." App. 80. In an effort to avoid the impact of that concession on the arbitrability issue, Plaintiffs assert that their statement was based on a lack of information. Response Brief 33. There was no such lack of information. As Plaintiffs' supplemental brief and supporting affidavit filed the day before the hearing on the arbitration motion make clear, Plaintiffs challenge the method of royalty calculation that was described in the affidavit of Kinder Morgan's expert filed with Kinder Morgan's motion to compel arbitration, long before Plaintiffs characterized their case as a "search for truth behind the Non-Qualified Contracts." Resp. App. 10, 11, 13, 37-39. Plaintiffs' disingenuous explanation of its statements in prior briefing is part of Plaintiffs' effort to avoid arbitration of the very type of claims that the parties agreed to arbitrate.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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